Nos. 518 and 536

In the Supreme Court of the United States

OCTOBER TERM, 1958

THE ATLANTIC REFINING COMPANY, CITIES SERVICE PRODUCTION COMPANY, CONTINENTAL OIL COMPANY, TIDEWATER OIL COMPANY, AND TENNESSEE GAS TRANSMISSION COMPANY, PETITIONERS

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, LONG ISLAND LIGHTING COMPANY, AND PUBLIC SERVICE ELECTRIC AND GAS COMPANY

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION AS AMICUS CURIAE

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OPINIONS BELOW

The opinion of the Court of Appeals (R. 653–662) is reported at 257 F. 2d 717. The opinions of the Federal Power Commission (R. 484–497) are reported at 17 F.P.C. 880.

JURISDICTION

The judgment of the Court of Appeals was entered on June 30, 1958 (R. 663). Petitions for re-

hearing timely filed were denied on August 27, 1958 (R. 667). The petitions for a writ of certiorari were filed in No. 518 on November 14, 1958 and in No. 536 on November 24, 1958. They were granted on January 12, 1959 (R. 669). The jurisdiction of this Court is based on 28 U.S.C. § 1254(1), and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

STATUTES INVOLVED

The pertinent portions of the Natural Gas Act, 52 Stat. 821, 15 U.S.C. 717, *et seq.*, are set out in the Appendix, *infra*, pp. 106–112.

STATEMENT

This proceeding concerns the validity of an order of the Federal Power Commission authorizing sales of natural gas by four independent producers to an interstate pipe line company for transmission and resale in interstate commerce.

The proceeding was initiated by the application of the four producers, Continental Oil Company, The Atlantic Refining Company, Cities Service Production Company and Tidewater Oil Company (the "Catco" group) for certificates of public convenience and necessity under Section 7 of the Natural Gas Act (15 U.S.C. 717f) authorizing the sale to Tennessee Gas Transmission Company of large quantities of natural gas produced from wells situated offshore Cameron and Vermillion Parishes, Louisiana (R. 519–520). Tennessee Gas and a number of Tennessee Gas' distributor customers and other interested parties intervened in the proceedings which were heard by a Commission examiner in February 1957 (R. 335).

The need for and physical feasibility of the proposed sale were conceded in effect by all parties, and the sole issue of any importance at the hearing concerned the proposed price at which the sales were to be made (R. 338–342, 350).

The interveners contended that the proposed price, 21.4¢ per Mcf, had not been shown to be just and reasonable or to meet the public convenience and necessity, and that the Commission should authorize the sales only if the parties to the sales agreed to accept a lower price. Various conflicting suggestions were made as to the price level which should be imposed by the Commission (R. 379, 389, 394).

The examiner found that the sales were required by the public convenience and necessity and recommended that they be authorized (R. 335–359). He found that the proposed price, 21.4¢ per Mcf, was higher than any price Tennessee Gas was then paying for gas, but was not higher than prices currently paid by other pipe lines for on-shore sales "for smaller reserves and smaller future potentials" (R. 351). The examiner also found that the weighted average cost of gas to Tennessee Gas would be increased by .97¢ per Mcf if the sale was certificated at the proposed price (R. 350–351); and that no showing had been made that filing of the proposed price would result in an increase in the price governing Tennessee's other purchase contracts (R. 353). He refused to condition the authorization of the new sale on acceptance of a price lower than that the parties had agreed upon, concluding that inasmuch as there had been no "showing of imprudence or of abuse of discretion by management"

in contracting for the sale, the proposed price could be accepted temporarily as consistent with the public convenience and necessity, pending rate review proceedings under Section 5(a) of the Natural Gas Act. The examiner's position was summarized as follows in his decision (R. 352):

> Therefore, assuming management has discretion, within its proper range, to make a selection as to sources of gas supply, and, in the absence of any substantial indication in the evidence or even serious claim by interveners that the initial cost of this gas by itself would necessarily lead to an increase in Tennessee's rates to jurisdictional customers, no grounds appear for permitting this case under Section 7 of the Act to assume the character of a rate proceeding under Section 5(a) thereof.

The Commission affirmed the examiner's finding that the physical service itself was required by the public convenience and necessity, but concluded that further evidence should be taken on the possible effect of the proposed rate level on the public convenience and necessity. It remanded for further proceedings on that issue, stating (R. 522) "By the procedures adopted here, however, we do not necessarily imply that the rates at which the proposed sales would be made are not in the public interest". Inasmuch as the Commission had found that the physical service was required by the public convenience and necessity, and the producers' leases as well as the Outer Continental Shelf Lands Act (67 Stat. 462, 43 U.S.C. 1335) required that service commence by the end of 1958, it granted the producers temporary certificates authoriz-

ing the proposed sales pending the further hearings ordered (R. 523–524).[1]

The producers, in motions for reconsideration of this order, stated that they could not accept the risk of beginning service pending determination of their applicable rate[2] (R. 398–399):

> Applicants have concluded that the nature and extent of the economic risk is such as to foreclose their acceptance of the aforesaid temporary certificates. * * *
>
> * * * Applicants could not present [cost] evidence within any reasonable period in the future. This fact alone would prevent the concluding of such hearing prior to the date that deliveries must commence under the contracts. The parties cannot afford to commence construction until at least the initial rate is resolved.

However, the producers, to allay any concern of the Commission as to loss of its continuing power to control the rates provided by the Catco contracts because of pending legislation,[3] offered to amend the contracts

---

[1] Tennessee Gas was also granted temporary authority to construct necessary connecting facilities to take the gas from the producers (R. 524).

[2] The Commission has consistently taken the position that acceptance of any certificate, temporary or permanent, carries with it an obligation to continue the service in question unless the Commission finds that abandonment is consistent with the public interest. See *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission*, 239 F. 2d 97 (C.A. 10), reversed on other grounds, 353 U.S. 944. Hence, the producers might not have been free to reject a permanent certificate subsequently offered them at a lower rate set by the Commission if they regarded that rate as inadequate.

[3] This was the so-called "Harris Bill", H.R. 6790, 85th Cong.

to eliminate existing provisions for periodic price increases and to authorize the filing of "indefinite" price increases which would be subject to the Commission's powers of review under the Gas Act or any pending subsequent amendment thereto.

The Commission, in response to this motion, ordered that the producers be granted permanent certificates authorizing the sales to Tennessee Gas (R. 530–533). The authorizations were conditioned, however, on the parties adopting the revised price increase provision proposed by the producers. In addition, the parties were asked to accept an initial price of 17¢ per Mcf, which was the highest price Tennessee Gas was then paying for gas, with the understanding that the producers would be allowed to file revised schedules increasing this rate to a maximum of 21.4¢, effective the day following commencement of deliveries, which rate would be suspended and placed immediately in effect subject to refund (R. 526–529). The order required that the proffered certificates, to become effective, must be accepted in writing by the producers within 30 days (R. 532).

Tennessee Gas, the purchaser, applied for rehearing of this order, stating (R. 418) that it had been "definitely advised by the producer-applicants that they will not amend Section 10 of the contract so as to change the initial rate from 21.4 cents per Mcf to 17 cents per Mcf", and that certificates in the form proffered by the Commission would be rejected by the producers and the contracts terminated.

The Commission granted the motion for rehearing and ordered argument of the questions presented by

the producer applications (R. 424–427). At the argument, producers' counsel made it clear that, if the Commission persisted in requiring an initial 17¢ per Mcf price, they would withdraw their certificate applications, terminate the contracts, and attempt to dispose of the gas through non-jurisdictional sales to industrial users in the Gulf Coast area, or elsewhere in the intrastate market.[4]

The Commission, as a result of the producers' position, reconsidered the question whether the public convenience and necessity justified certificating the sales at the proposed price. The Commission had found in its original order that it could not authorize the sales at the 21.4¢ per Mcf price consistent with the public convenience and necessity (*supra*, p. 4) although it pointed out that there was nothing in the record to indicate that that price was in any way unreasonable.[5] It had also found (R. 521) that the sale, apart from price, was required by the public convenience and necessity since (1) there was a tremendous unsatisfied need for gas in the areas served by Tennessee Gas' system; (2) the Catco reserves were the only known large scale uncommitted reserves located at an economical distance from Tennessee Gas' line so that it was highly uncertain whether comparable gas reserves could be substituted for the Catco gas; and (3)

[4] Transcript of oral argument, Docket No. G–11024, *et al.*, June 12, 1957, pp. 348–369, 415–435.

[5] The 21.4¢ per Mcf price was equal to or lower than a number of other current prices for gas produced in the same area from wells on dry land (R. 351), and the Catco wells were located between 15 and 25 miles offshore in the Gulf of Mexico in as much as 90 feet of water (R. 520).

the Catco gas, assuming that the producers persisted in their refusal to sell in the interstate market at a price fixed initially by the Commission, would in all probability be employed as boiler fuel by industrial purchasers—a low grade and socially wasteful use of this fuel.

Since it would have been impossible, practically speaking, for the Commission to evaluate critically the producers' repeated statements that they would refuse to sell their gas at a 17¢ price, the Commission was confronted with the possibility, if not the probability, that the gas would be lost to residential and other high-grade consumer uses in the interstate market, should it impose a price condition. Faced with this conflict between the demonstrated need for the gas and the producers' announced intention of exercising their right to refuse to sell except at their own price, the Commission felt forced to reexamine its earlier conclusion that the sales could not be authorized at the contract price consistent with the public convenience and necessity. As its order stated (R. 487), it confronted "the difficult problem of how to assure the delivery of [the Catco] gas to the large market served by Tennessee Gas, and at the same time protect the consumers from an unreasonably high price".

Weighing against the need for a price condition was the fact that the price differential of 4.4¢ per Mcf between the contract price and the proposed conditioned price, if ultimately found unreasonably high, could affect consumers only during the period between commencement of sale and Commission deter-

mination of a reasonable price for the gas in Section 5(a) proceedings which had been or would be ordered by the Commission involving the producers' rates; and even during this period, the higher contract price could have an adverse effect on consumers only if Tennessee Gas were to pass it on to its distribution company customers which, in turn, passed it on by rate increases to their customers, the consumers.

Assuming that Tennessee had been allowed to pass on the increase, the average price paid by distributors for Tennessee's gas during the current period would have increased only 1.4 per cent as a result of Tennessee Gas' purchasing the Catco gas at the 21.4¢ per Mcf price, rather than the proposed 17¢ price.[6] On the further assumption that the distributors in turn were able to pass on to their customers the one-half cent per Mcf increase, this would still have amounted only to a small fraction of the cost of the gas to the residential consumers.[7] See *infra*, pp. 102–103.

The Commission concluded, therefore, that the risk of adverse effect on the consumer from the 21.4¢ gas was sufficiently slight to be more than overbalanced

[6] That is, Tennessee's current average price to distributors as shown by the Commission's records is 36¢ per Mcf. Assuming that the full average price increase to Tennessee, as a result of purchasing at 21.4¢ per Mcf rather than 17¢ per Mcf, or .488¢ per Mcf, was passed on to its distributor customers, this would amount to an increase of 1.4 per cent over the current average price paid by distributors.

[7] The rates paid for gas by residential consumers in three states served by Tennessee Gas, New York, New Jersey and Massachusetts, ranged between $1.52–$2.20 per Mcf in 1957. Mines Mineral Market Report M.M.S. No. 2833, U.S. Department of Interior, Bureau of Mines.

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by the need for that fuel in the Tennessee Gas system. It reconsidered and reversed its original finding that the contract price had not been shown to be consistent with the public convenience and necessity, and authorized the sales at 21.4¢ per Mcf pending review of this price under Section 5(a) (R. 489–492). Concurrently, it ordered that the 21.4¢ price be investigated as to reasonableness in Section 5(a) proceedings covering the sales of each of the four producers,[8] stating that "By this means relief can be afforded to the consuming public if it should be found that the 21.4 cent initial rate to be charged for the off-shore gas is excessive" (R. 488).[9]

The New York Public Service Commission, and two gas distributors purchasing from Tennessee Gas, applied for rehearing of the Commission's order (R. 447–474), and when this was denied (R. 541) sought review of the order in the Court of Appeals for the Third Circuit under Section 19(b) of the Natural Gas Act (15 U.S.C. 717r(b)). The Third Circuit vacated

[8] Three of these investigations, involving the rates of The Atlantic Refining Company, Tidewater Oil Company, and Continental Oil Company were then in progress; the Commission's order directed that a fourth Section 5(a) proceeding be held concerning the rates of the remaining producer, Cities Service Production Company (R. 488). The Section 5(a) proceedings initiated by the Commission are currently in hearing, and rate determinations involving the Catco sales will be made as soon as sufficient service experience becomes available to permit comparison of operating costs and revenues.

[9] The Commission also required the applicants to amend their contracts to eliminate fixed price escalation provisions and substitute "indefinite pricing clauses" as originally proposed by the producers in their motion for reconsideration of the Commission's first order (R. 489–491).

the certificate order mainly on the grounds discussed *infra*, pp. 19–30.

SUMMARY OF ARGUMENT

I

The Commission did not seek certiorari in this proceeding in view of the pendency of *Oklahoma Natural Gas Co.* v. *Federal Power Commission* (No. 288, this Term, dismissed, February 20, 1959); and given the present posture of this case, it does not urge that the decision below be reversed.

II

The grounds expressed by the Court of Appeals for its decision are patently erroneous, however, and should be disapproved by this Court. A regulatory body is not deprived of jurisdiction to consider an application for a certificate of public convenience and necessity merely because the applicant indicates its unwillingness to aquiesce in a revision of its proposal which has been suggested by the agency. The fact that an applicant remains free to refuse to serve at terms proposed by the agency does not mean that it can limit or control the agency's examination of the public interest in the proposed service.

III

Broad questions sought to be raised by the petitioners as to the validity of the Commission's practice in certificating proposed services by gas producers need not be reached by this Court. These issues were neither argued to nor decided by the lower court

which expressly refused to pass upon them. Rather, the issue raised by the petitioners below was whether the Commission should have certificated the proposed service, given the facts and procedural history of the Commission proceeding. The Third Circuit, as noted, appears to have decided the case on jurisdictional grounds. If this Court disapproves, as we urge that it do, the grounds of the decision below, it need not reach the broad questions raised by the petitioners. Despite the importance of the broad questions, and the need for ultimate consideration by this Court, we believe that the present record, because of its atypical character, does not fully reflect all facets of the public interest in the certification of new gas services. Hence, there are sound reasons why the Court should defer consideration of these issues until such time as they are squarely presented on an adequate record, such as that now pending hearing before the Third Circuit in *United Gas Improvement Co. and Philadelphia Electric Co.* v. *Federal Power Commission,* and *Public Service Commission of New York* v. *Federal Power Commission.*

IV

Should the Court reach the broader questions raised by the petitions, the language, history and purpose of the Gas Act unite in demonstrating that the Commission need not find that a proposed natural gas rate is "just and reasonable" before certificating a new gas service.

A. Sections 4 and 5(a) of the Natural Gas Act (App., *infra,* pp. 106–109) establish standards and

procedures for testing the lawfulness or "justness and reasonableness" of existing gas rates on file with the Commission. The conspicuous absence of any reference to these standards or procedures in Section 7(e) of the Gas Act, governing certification of new services, indicates that the sole test to be applied to proposed rates is that set out in the certification provision in Section 7(e), "public convenience and necessity". This is confirmed by the deliberate failure of Congress to give the Commission suspension power over initial rates, as well as by the uniform interpretation given the "public convenience and necessity" standard as requiring an evaluation and balancing of all factors affecting the public interest, including the public need for gas. This does not mean that proposed rates are not relevant to the public convenience and necessity, for quite the contrary, they are a factor which must always receive consideration, but only that proposed rates need not be evaluated under a standard independent of public convenience and necessity.

B. The legislative history both of the original Gas Act and the 1942 amendments adding the existing Section 7 certificate provisions, demonstrate that proposed rates are only one of a number of factors which Congress intended the Commission to consider in authorizing new gas services, and that no one factor can be given predominate weight in every case under the congressionally approved standard.

C. This conclusion is further confirmed by the consistent refusal to appraise the reasonableness of proposed rates in certificate proceedings of every federal

regulatory body administering a statute parallel or equivalent to the Gas Act.

D. The District of Columbia Circuit, the only court thus far to pass on the question, has twice held in *Florida Economic Advisory Council* v. *Federal Power Commission,* 251 F. 2d 643, certiorari denied, 356 U.S. 959, and *Oklahoma Natural Gas Co.* v. *Federal Power Commission,* 257 F. 2d 634, dismissed, February 20, 1959, that the Commission need not find proposed rates just and reasonable before certificating new gas services.

V

A. The Commission has not abused its discretion in refusing in the great majority of certificate proceedings to pass on the reasonableness of proposed gas rates. Although the Commission has imposed specific or contingent rates in a small number of pipeline certificate proceedings where serious questions of lack of economic feasibility or dangers of discrimination were presented, it would not have been feasible or desirable to follow this practice in all contested producer certificate proceedings during the early stages of producer regulation. Marked economic and technical differences between the pipeline and producer industries would have made it impossible to apply the formulas, principles and techniques of pipeline regulation directly to the independent producers. In the absence of a workable rate formula, the Commission could not set reasonable rates in producer certificate proceedings. It would also have been impracticable during the early stages of producer regulation to defer consideration of the reasonableness of proposed

rates by imposing contingent or interim rates. Such a procedure, if followed in all contested cases, would have tended to stifle gas production to the heavy detriment of consumers, if only because the absence of established rate formulae or regulatory principles would make it impossible for the producer prior to drilling to forecast even the general area of the rate which ultimately would be found reasonable by the Commission. Additionally, it would be impracticable in a majority of cases for the Commission to determine the reasonableness of isolated rates governing proposed individual sales, because of the need to make cost allocations based on the over-all operations of the producer, which can only be accomplished in system-wide Section 5(a) proceedings. Such Section 5(a) proceedings are now in progress involving almost all major producers and production areas. The information obtained in these proceedings will provide a necessary first step toward development of the formulas and technique which will make possible effective producer rate regulation in the consumer interest.

B. During the present, initiating period of producer gas regulation, gas consumers have not been injured as a result of the Commission's practice of not pre-determining initial producer rates in producer certificate proceedings. The average price paid by residential gas consumers has increased only slightly during this period, less than the average increase in consumer prices, despite rising costs incurred by gas pipelines and producers.

It follows that the procedures employed by the Commission in certificating producer sales have been fully

consistent with the main purpose of the Act, and that there is no justification for restricting the Commission's discretion at this stage of producer regulation to the use of any preconceived method or formula of producer regulation.

ARGUMENT

I

THE INTEREST OF THE FEDERAL POWER COMMISSION

The Federal Power Commission has a clear and obvious interest in this proceeding which involves the validity of certificates and orders issued by it pursuant to Section 7 of the Natural Gas Act. Since the Commission did not seek certiorari to review the judgment of the Third Circuit, and has not been named as respondent, it files this brief *amicus curiae* in order to apprise the Court of its view of the opinion and decision below and the scope of the issues before the Court.

The Third Circuit's decision issued shortly after the ruling of the District of Columbia Circuit, favorable to the Commission, in *Oklahoma Natural Gas Co.* v. *Federal Power Commission,* 257 F. 2d 634 (certiorari granted, 358 U.S. 877, dismissed on petitioner's motion pursuant to Rule 60, February 20, 1959). The *Oklahoma Natural* decision raised certain important questions as to the scope of the Commission's regulatory authority and the validity of its procedures in certificating new sales of independent producers of natural gas. In view of the current importance of these issues for the administration of the Natural Gas Act, the Commission

did not oppose the grant of certiorari in *Oklahoma Natural* when review was sought in that proceeding in August 1958.

The broad questions of statutory authority and administrative discretion involved in the *Oklahoma Natural* proceeding were not argued to the Third Circuit in the present cases, see *infra*, pp. 19–27; and its opinion on June 30, 1958, which expressly pretermitted those issues, seems largely based on other grounds. Although the Commission disagreed vigorously with the stated grounds of the decision below and sought rehearing (R. 666), the actual decision (as contrasted with the opinion) appeared at that time to rest mainly on its particular facts and hence not to raise a question of general importance appropriate for resolution by this Court.

Additionally, when the Commission and the Solicitor General were required to consider applying for certiorari following denial by the Third Circuit of its application for rehearing on August 28, 1958, intervening events had further reduced the significance of the Third Circuit's decision. In July 1958, the producer applicants began sales to Tennessee Gas pursuant to the Commission authorization.[10] Hence, when the court below denied rehearing in August 1958, it was no longer possible for the producers to abandon their service to Tennessee Gas, absent a finding by the

[10] The Third Circuit has stayed issuance of mandate pending review by this Court (R. 668). During the period July 1958 through December 1958, Tennessee Gas purchased 17,049,256 Mcf of gas from the Catco reserves under the contracts here in question at a cost of $3,869,536.

Commission under Section 7(b) of the Natural Gas Act (15 U.S.C. 717f(b)) that this was consistent with the public convenience and necessity. *J. M. Huber Corp.* v. *Federal Power Commission,* 236 F. 2d 550 (C.A. 3), certiorari denied, 352 U.S. 971; *Sunray Mid-Continent Oil Co.* v. *Federal Power Commission,* 239 F. 2d 97 (C.A. 10), reversed on other grounds, 353 U.S. 944; see also *Pennsylvania Water & Power Co.* v. *Federal Power Commission,* 343 U.S. 414, 421-424. It followed that the producers—solely as a result of their decision to begin service while a petition to review the Commission's order was still outstanding—were no longer free to refuse to sell their gas and to reject a permanent certificate. In view of this fact and inasmuch as the Third Circuit's judgment in effect requires reimposition of the original contingent price requirement which the Commission had revoked to ensure the availability of the Catco gas to Tennessee's customers, the Commission concluded that the decision below (as opposed to the stated grounds for that decision) had ceased to have general significance.[11]

For these reasons, the Commission did not seek certiorari, and it does not now urge that the decision below be reversed. But the Commission does urge strongly that the main grounds on which the court below appeared to reach its decision should be disapproved by this Court, since these are patently erroneous and will, if allowed to stand, introduce wholly unnecessary confusion into the principles governing review of federal agency action.

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[11] We appreciate, of course, that the decision may retain considerable economic significance for the present petitioners.

Moreover, the parties to these cases have raised the broader issues which were presented in *Oklahoma Natural,* No. 288, and it is therefore appropriate, now that No. 288 is no longer before the Court, for the Commission to set forth its position on those questions in these cases—if the Court should reach the broader issues.

II

THE MAIN GROUNDS GIVEN FOR THE DECISION BELOW ARE ERRONEOUS

A. *The Commission had jurisdiction to consider the producer applications.* The Third Circuit seems to have declared that the Power Commission had no jurisdiction to consider a natural gas company's proposal for a service extension where the proposal included a firm price (based on a negotiated contract) for the sale of gas, and the company refused to accept an alternative price suggested by the Commission. The grounds expressed for this conclusion are not that the Commission should have refused in this particular case to authorize the service, but rather that it had no jurisdiction even to consider the proposal on the terms submitted by the company. As the Third Circuit stated at the outset of its discussion (R. 658):

> The petitioners pose substantially similar questions on the merits of the case, namely, whether the Commission committed error in its order of June 24 * * * We conceive of the question, however, as a more fundamental one, involving the statutory jurisdiction of the Federal Power Commission. *It is whether the Commission has authority to consider an ap-*

> *plication for a certificate under Section 7(e) where the terms of the application limit the scope of the inquiry which the Commission is required to make for a determination of public convenience and necessity.* [Emphasis added.]

The court below has concluded therefore that the Commission (and by extension any comparable federal regulatory agency) cannot even consider a service proposal where the applicant limits its proposal to specified terms and conditions and indicates its unwillingness to provide the service on another basis. Thus, the court states in elaboration (R. 662):

> Congress has not given the Commission power to inquire into the issue of public convenience and necessity where, as here, the applicant circumscribes the scope of that inquiry by attaching a condition to its application requiring the Commission to forego the consideration of an element which may be necessary in the formulation of its judgment. Otherwise stated, the Commission has not been endowed by Congress with jurisdiction to conduct a *limited* inquiry.

In the court's view, a regulatory body does not even possess jurisdiction to examine a service application once the applicant has made it clear that it contains a firm provision of any kind, since such a provision would require "the Commission to forego the consideration of an element which may be necessary in the formulation of its judgment" (R. 662).

This is a startling conclusion. Most new service applications to regulatory bodies are inferentially or explicitly made on a firm basis, and applicants fre-

quently indicate at some point in the proceeding that they will not go forward with their proposals unless certain minimum terms are accepted by the agency. Since an applicant, with certain limited exceptions, generally cannot be compelled against its will to provide a service (*infra*, pp. 26–27), it is entirely proper, and may even be necessary, for it to express its views as to whether or not proposed conditions or revisions of its application by other parties or the agency would be acceptable to it.

Furthermore, such expressions of intent or opinion on the part of an applicant cannot, as the court below believed (R. 662), in any way "circumscribe" the scope of the Commission's inquiry, which should and can go forward to its normal conclusion regardless of the applicant's position. Thus, to take an example, an applicant seeking a broadcasting license from the Federal Communications Commission could, with propriety, at any point in the proceeding inform the Commission that it would not accept a license limited to a certain transmission power output (or any other such restriction), because in its view the limitation would make the service uneconomic. This would not prevent that Commission from continuing to explore all of the factors affecting the public interest in the broadcasting area in question. At the conclusion of its investigation, the Commission could either approve the application as submitted, reject it, or offer the applicant an alternative which it (the applicant) could then accept or reject. Similarly, an applicant for a transportation license before the Interstate Commerce Commission or Civil Aero-

nautics Board cannot limit the scope of the agency's inquiry merely by proposing a specific and definite service extension, since the agency's powers of inquiry are entirely independent of the positions taken by applicants before it.

It follows that there was nothing illegal in the producers rejecting the alternative price proposed by the Commission in this case on the ground that the sale would not produce a sufficient return at the 17¢ per Mcf rate. The fact that the producers took such a position could not in any way have circumscribed or limited the Commission's consideration of the issues bearing on the public convenience and necessity.

Additionally, since, as we have said, firm proposals are more the rule than the exception in federal licensing proceedings, the decision below, if literally applied, would seemingly cast doubt upon the large number of licenses or certificates granted by federal agencies where the applicant has insisted on the retention of a particular term and made its position clear at any point in the proceeding. Although we do not believe that the decision was intended to have this scope, but rather to be limited to some extent at least by the particular history and facts of this case, the bare possibility of such an interpretation serves to expose the fallacy at the root of the Third Circuit's reasoning.

B. *No issue is presented as to the applicants' willingness to conform to the provisions of the Natural Gas Act.* The court below attempted to buttress its conclusion that the Commission lacked jurisdiction over these producer applications by asserting that

"The action of the applicants in curtailing the decision-making power of the Commission demonstrates their unwillingness to conform to the provisions of the Act; this in itself would require the denial of the applications" (R. 662). We have shown that an applicant cannot "curtail" the Commission's "decision-making power", since the Commission's final decision can always be entirely independent of any position taken by an applicant. It is clear, moreover, that the specification by an applicant as to the conditions under which it will institute service does not *per se* constitute unwillingness "to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder", in the sense meant by Section 7(e) of the Gas Act, App., *infra*, p. 111.

The Commission may of course deny an application proposing an act or operation as not "required by the present or future public convenience and necessity", unless the applicant accepts certain modifications. However, the standard of "conform[ity] to the provisions of the Act," which is derived from an identical provision in Part II of the Commerce Act (49 U.S.C. 307(a)) (*infra*, pp. 69–71), has been interpreted uniformly by the Interstate Commerce Commission as requiring an estimate of the probability of an applicant's future compliance with Commission rules and regulations, rather than as a supplement to or expansion of the substantive standard embodied in the term "public convenience and necessity". The Interstate Commerce Commission, in determining whether an applicant will "conform to

the provisions of the Act", looks primarily to its past record of compliance with Commission rules and regulations. Applicants have been denied a certificate under this standard because of the evidence of past violations of Commission rules governing safety devices and programs, hours of service, medical tests, accident and other reports, accounting regulations, and unauthorized service. The Commerce Commission has never interpreted this language as proscribing an applicant merely because it has announced its intention of rejecting a certificate, should it include or omit particular provisions. See, *e.g.*, *Burnham Warehouses, Inc.*, 67 M.C.C. 799, 800; *Fortier Transportation Co.*, 67 M.C.C. 653, 655; *Fred L. Ridge*, 64 M.C.C. 69, 79; *L-P Gas Transport, Inc.*, 61 M.C.C. 611, 612, 620–621; *Paul D. Hurley*, 54 M.C.C. 362, 364; *Mathews Trucking Corp.*, 53 M.C.C. 737, 755–758; *Hughes Transportation, Inc.*, 46 M.C.C. 603, 622; *Harold F. Miller and J. T. Cahill*, 30 M.C.C. 737, 742–743; *Ralph G. Mattison*, 6 M.C.C. 353.

It follows that an applicant for a certificate under Section 7(e) of the Gas Act is not automatically disqualified merely because it refuses to acquiesce in a revision to its application proposed by the Commission.

C. *An applicant cannot be compelled to accept a certificate under Section 7 of the Gas Act.* The major grounds expressed for the Third Circuit's decision suggest that the Court *may* have been under the misapprehension that a natural gas company, once it has filed a service application under Section 7, can be compelled to accept a certificate of public convenience and

necessity on the Commission's terms. Although the opinion below does not take this position explicitly, much of what it says seems to be based on this premise. Thus, the court, as previously stated (*supra*, pp. 19–20) concluded that the Commission had no jurisdiction to give further consideration to the producers' application once they had indicated their unwillingness to accept a 17¢ per Mcf price. This implies that an applicant—in order to obtain consideration of his application and ultimate certification—must agree in advance of the hearing to accept whatever certificate is offered him by the Commission since otherwise his intransigence will oust the Commission of jurisdiction. Were this in fact the case, then once an applicant committed himself by filing an application, the Commission would have the practical power to compel him to serve on such terms as it might dictate in accordance with the statutory standards—if it had any jurisdiction at all over the application.

That this assumption may underlie the opinion below is also suggested by the court's further statement that (R. 662):

> Congress has also made it clear that the applicant must be *willing* to perform the services proposed and conform to the provisions of the Act. The action of the applicants in curtailing the decision-making power of the Commission demonstrates their unwillingness to conform to the provisions of the Act; this in itself would require the denial of the applications. The Commission's function is to regulate the sale of gas by producers willing to sell under regula-

> tions arrived at in accordance with the provisions of the Act. Such regulations may not be the result of bargaining with an unwilling seller.

The conclusion that the Commission should not "bargain" must mean that the Commission cannot explore the public convenience and necessity in the combined light of the applicant's proposals, the Commission's counter-proposals and the applicant's acceptance or rejection of those counter-proposals. But if the Commission does not have to consider the applicant's proposals, it can only be because it has the power to *compel* it to serve on the Commission's terms.

Whatever assumptions underlay the Third Circuit's opinion, however, it is clear that the Commission has no authority to compel an applicant to serve. The Gas Act, with certain very limited exceptions in Section 7(a), does not require natural gas companies to start serving on terms unacceptable to them. Section 7(a) of the Act, App., *infra*, p. 109, contains a limited power to compel a pipeline company to serve distributors in its immediate area. This provision, which is hedged with numerous conditions, completely negates the existence of any general Commission power to compel institution of service under Section 7(e). The legislative history of both the 1938 Act and the 1942 amendment to Section 7 of the Act also leave no doubt that an applicant cannot be compelled to serve. H. Rep. 709, 75th Cong., 1st Sess., pp. 5–6; Hearings, House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., on H.R. 5249, p. 23. Further, the courts which have

passed on this question have uniformly held that the Commission has no authority to require a gas company to add to its investment on terms unacceptable to it. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 204 F. 2d 675, 678–681 (C.A. 3); *Central West Utility Co.* v. *Federal Power Commission*, 247 F. 2d 306, 312–313 (C.A. 3); cf. *Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498.

Hence, assuming that the opinion below is based on such a supposition, there can be no doubt that it rests upon a fundamental misapprehension as to the scope and purpose of the Natural Gas Act.[12]

III

QUESTIONS RAISED BY PETITIONERS AS TO THE GENERAL SCOPE OF COMMISSION AUTHORITY UNDER SECTION 7 OF THE NATURAL GAS ACT NEED NOT NECESSARILY BE REACHED BY THIS COURT IN THIS CASE

The petitioners in their separate statements of the questions presented invite this Court's consideration of a broad question as to the proper exercise of the Commission's certification authority under Section 7 of the Gas Act. Tennessee Gas Transmission Company, petitioner in No. 536, presents the following question as ripe for this Court's consideration (p. 2):

> Whether the Commission must, in an independent producer certificate case, determine the justness and reasonableness of the initial price

[12] Since the grounds selected by the court for its decision had not been argued or mentioned by any party at the time of its decision, the court did not have the benefit of briefs or citation of authority on this problem.

> when a question is raised as to the propriety of such initial price, or whether it can defer such matter for determination in a full rate investigation under Section 5(a) of the Natural Gas Act.[13]

Petitioners thus seek to raise in this Court an issue which neither they nor any intervening party argued to the Court of Appeals, and which was expressly pretermitted by the court below. It would appear, as we shall indicate, that this broad issue need not be reached by this Court in order to affirm the judgment in this case. Should the Court elect, however, to decide that statutory issue, the Commission's position is set forth in Points IV and V of this brief, *infra*, pp. 32–104.

As the petitioners admit (petition in No. 536, p. 18; see also petition in No. 518, p. 7), the "basic issue" presented to the Third Circuit by all parties below was "whether the Commission abused its discretion by declining to condition the certificate on a lower initial price", in the particular circumstances where it had twice found on the same record such a condition to be required by the public convenience and necessity. Since the Commission had reversed itself on this issue without receiving additional evidence, the petitioners below[14] argued that the Com-

[13] Basically the same question is stated by the parallel petition for writ of certiorari in No. 518, p. 2:

> Must the Commission convert a certificate proceeding, under Section 7 of the Natural Gas Act, into a rate case when a question is raised as to the initial price?

[14] The Public Service Commission of New York in No. 12,401, and Long Island Lighting Company and Public Service Electric and Gas Company in No. 12,403.

mission's subsequent finding that the 21.4¢ per Mcf price met the public convenience and necessity was not supported by sufficient evidence. The issue, as thus framed, is summarized in the Third Circuit's opinion (R. 660–661):

> The Commission defends its action by claiming the right to change its mind just as a court might do on rehearing, citing *Cia Mexicana de Gas* v. *Federal Power Commission,* 167 F. 2d 804 (C.A. 5, 1948). The petitioners, however, do not argue to the contrary. Their position is that, since in its first two orders the Commission determined that the record lacked sufficient evidence upon which to base a finding that the sale at the proposed rate would be in the public interest, and as the final order was based upon the same record, there is still insufficient evidence to support such a necessary finding.

None of the parties before the Third Circuit argued that the Commission was required by the Gas Act to make a determination of the "justness and reasonableness" of a proposed initial price, within the meaning of the rate sections of the Act, before certificating new gas sales under Section 7(e), App., *infra,* p. 111, the broader question which the present petitioners now seek to present. Rather, the petitioners below (see footnote 14, *supra,* p. 28 (respondents here)), argued that the Commission is required in contested cases to appraise a proposed rate in the light of the "public convenience and necessity," the applicable standard under the certificate provision in Section 7(e); and that it had failed to do so in this case because of the inadequacy of the record, and

hence had abused its discretion. Since the Commission has never at any point contested this general principle, and argued below that it had made such an appraisal in this case, the issue between the parties in the court below reduced to the question whether in fact the Commission had made an adequate appraisal in this particular case and on this particular record.

The Court of Appeals did not appear to reach the issue thus presented by the parties, since it held that the Commission should have dismissed the application for lack of jurisdiction, *supra,* pp. 19–20. It also pretermitted for the same reasons the broad questions presented here by petitioners which had been suggested, not by the parties, but by the intervening *Oklahoma Natural* decision. As the opinion states (R. 659):

> While the Commission probably should always consider the impact of the proposed initial rate in its determination of public convenience and necessity, we do not reach the question of whether the Commission must fix the initial rate when its inquiry demonstrates that there is a substantial question of the reasonableness of that initial rate. See *Oklahoma Natural Gas Co.* v. *Federal Power Commission,* and the dissenting opinion of Judge Bazelon, —— F. 2d —— (C.A.D.C., decided May 22, 1958).

If this Court determines, for reasons which we have set forth (*supra,* pp. 19–27), that the grounds relied on by the Third Circuit are clearly incorrect and must be disapproved, then the primary question before it

will be whether the Commission erred in granting a certificate on the facts of this particular case.

Should the Court invalidate the Commission's ultimate finding that the 21.4¢ per Mcf rate met the public convenience and necessity on the ground that it was not supported by sufficient evidence, and hence constituted an abuse of discretion in the circumstances of this particular case, the judgment below could be affirmed without reaching the question of whether the Commission *must* make a finding of justness and reasonableness or impose a contingent price in *every* disputed Section 7(e) certification proceeding.

We do not urge that the judgment below in this case should be reversed. We submit, also, that there are sound reasons why the Court should not undertake to decide these broader questions on this record. Although we believe that the broader issues are sufficiently important so that they should ultimately be decided by this Court, the present record because of its atypical character, unlike the *Oklahoma Natural* proceeding, does not fully reflect the various factors—legal, economic and practical—which affect or constitute the public interest in natural gas services and which should therefore receive consideration by the Commission and the courts in ascertaining public convenience and necessity.

Furthermore, the issue raised by petitioners is squarely presented in proceedings now pending before the Third Circuit on petitions to review a Commission order, issued on a record comparable in scope and character to that in *Oklahoma Natural,* which authorized sales by natural gas producers at a price chal-

lenged by one of the present respondents, after a Commission finding that the proposed price met the public convenience and necessity. *United Gas Improvement Co. and Philadelphia Electric Co.* v. *Federal Power Commission*, C.A. 3, No. 12,797; *Public Service Commission of New York* v. *Federal Power Commission*, C.A. 3, No. 12,805. Since the Commission refused in those cases to make findings as to the reasonableness of the proposed rates, or to require a contingent rate, the Third Circuit will have an opportunity to decide the basic issues which it did not reach in the present case; and its decision will be reviewable on certiorari by this Court.

IV

THE COMMISSION IS NOT REQUIRED TO FIND PROPOSED GAS RATES "JUST AND REASONABLE" BEFORE CERTIFICATING GAS SERVICES

We have pointed out (*supra*, pp. 27–32) that the Court need not reach the general issues presented by petitioners as to the validity of the Commission's customary treatment of initial rates proposed by independent producers, since there is a prior question before the Court as to the exercise of the Commission's discretion on the particular facts of this case. Should the Court undertake to decide the broader questions, however, the Commission's position is set forth in the balance of this brief.

Petitioners have argued that implicit in the decision below is the holding that the Natural Gas Act requires the Commission, before certificating a proposed gas service, to find in every case that the price

agreed on by the parties to the sale is "just and reasonable". In this view, the Third Circuit has decided that the Commission must either hold a rate hearing prior to granting a certificate or that it must require as a condition to authorizing the service that the seller accept retroactively the rate found reasonable in a subsequent rate hearing.

We have already noted (*supra*, pp. 28–30) that this broad issue was not reached (in our opinion) by the Third Circuit. We shall now show that in any event the Gas Act contains an explicit mechanism for reviewing wholesale gas prices which is restricted in application to prices on file in *existing* rate schedules, and does not apply to rate *proposals* in Section 7(e) certification proceedings. Thus, although the proposed rate is plainly an element affecting the public convenience and necessity which the Commission must consider in authorizing new gas services (see *infra*, pp. 39–47), it need not make a formal rate determination as a precondition to every service authorization; such a determination in appropriate cases can properly be made in separate Section 4(e) and Section 5(a) proceedings passing upon the rate schedules filed by the company seller.

We shall also show that this view of the Act is entirely consistent with and fully supports the primary purpose of Congress in protecting the consumer against unreasonable gas rates, and with this Court's prior interpretation of the Act in cases, *inter alia*, such as *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591; *Phillips Petroleum Co.* v.

State of Wisconsin, 347 U.S. 672; and *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332.

A. THE LANGUAGE OF THE NATURAL GAS ACT DEMONSTRATES THAT FORMAL GAS RATE DETERMINATIONS ARE TO BE MADE IN PROCEEDINGS UNDER SECTIONS 4(e) AND 5(a), NOT UNDER SECTION 7(e)

1. *The standard of "just and reasonable" applies only to rate proceedings under Sections 4 and 5; the omission of power to suspend initial rates shows that the just and reasonable test does not apply to such rates.* Sections 4(a)–4(e), together with Section 5(a) (App., *infra*, pp. 106-109), are the only provisions of the Natural Gas Act expressly concerned with rates.

Sections 4(a) and 4(b) contain a statement of principles or standards which the Commission must apply in appraising rates through the procedures outlined in the balance of Section 4. Section 4(a) states that "All rates and charges made, demanded, or received by any natural-gas company" for jurisdictional sales or transportation of natural gas must be "just and reasonable" and declares unlawful any such rate which is unreasonable. This provision on its face is thus confined to rates "made, demanded, or received", and does not refer to the proposed rates submitted with new service applications under Section 7(e). Section 4(b) proscribes unreasonable differences in such rates "as between localities or as between classes of service." Procedures for applying these standards are set forth in the three remaining subsections of Section 4. Section 4(c) requires that natural gas

companies file "schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission"; and Section 4(d) requires advance notice of any change in a schedule on file by filing substitute schedules.

Revised schedules filed pursuant to Section 4(d) may be set for a hearing by the Commission "concerning the lawfulness of such [changed] rate" pursuant to Section 4(e), and the Commission "after full hearings * * * may make such orders with reference thereto as would be proper in a proceeding initiated after it [i.e., the changed rate] had become effective."[15]

As this Court recognized in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 340–341, the standard to be applied in reviewing rate changes under Section 4(e) is the same standard which is applied in appraising existing rates under Section 5(a) of the Act, which in pertinent part provides:

> *Whenever the Commission,* after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, *shall find that any rate,* charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is *unjust, unreasonable, unduly discriminatory, or preferential, the*

[15] Section 4(e) also provides for suspension of a rate change for a maximum of five months; the revised rate may be placed in effect subject to refund at the end of the suspension period.

> *Commission shall determine the just and reasonable rate*, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: * * *. [Emphasis added.]

See also *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division*, 358 U.S. 103, 112 (fn. 7).

It will be noted that Section 5(a) (App., *infra*, pp. 108–109) incorporates expressly the principles stated in Sections 4(a) and 4(b): that is, it authorizes the Commission in its discretion to initiate a rate hearing, and to find that any rate incorporated in a field rate schedule is (1) unreasonable or (2) discriminatory and to "determine the rate * * * to be thereafter observed".

The certification provision, Section 7(e) (App. *infra*, p. 111), to the contrary, in providing for regulation of proposed services or facilities, makes no mention of the two rate standards contained in Section 4(a). It states that the Commission may grant a certificate

> * * * if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; * * *.

The failure to incorporate the two rate standards of reasonableness and non-discrimination in Section 7(e), coupled with their express incorporation in Section 5(a), cannot have been accidental; it demonstrates a clear Congressional purpose to adopt in Section 7(e) the traditional test of the "public convenience and necessity", not requiring formal rate determinations, which rather are to be made in proceedings under Sections 4(e) and 5(a) of the Act.[16]

In short, the inclusion of an express mechanism for applying the statutory rate standards in Sections 4(e) and 5(a) but not in Section 7(e) suggests on its face that the formal rate findings called for by the statutory standard ("just and reasonable") are to be made in hearings after the service has commenced, not in certificate proceedings. That this is the case is confirmed by the failure of Congress to give the Commission the authority to suspend *initial* rates in Section 4(e), which authorizes the Commission to suspend

[16] We have shown, *supra*, pp. 22–24, that the requirement in Section 7(e) (App., *infra*, p. 111), that an applicant be able and willing "to conform to the provisions of the Act" does not constitute a substantive test over and above "public convenience and necessity" by which the elements of the proposed service are to be appraised, but rather is a test of the applicant's ability and good faith. This language, as we have shown, *supra*, has been consistently interpreted as requiring a forecast of the probability that the applicant will obey lawful Commission regulations and orders, and conform to the reporting, accounting, and other similar requirements of the Act. The language in Section 7(e) does not incorporate the Sections 4–5(a) standards, therefore, so as to make proposed rates a test of the applicant's willingness to conform to the Act's provisions.

only rate changes filed under Section 4(d).[17] Had Congress intended to give the Commission an invariable duty of review, and an automatic veto, over the initial rates made by gas companies, it would almost undoubtedly have done so by making Section 4(e) (including its incorporation of the Section 5(a) standard) apply to all rate filings—not merely to rate changes. See *infra*, pp. 51–69. This would have allowed the Commission to set for hearing and suspend *initial* rate schedules when it regarded these rates as suspect.

Congress employed this technique in the Motor Carrier Act (49 U.S.C. 301, *et seq.*) which served as a model for the Natural Gas Act—including in particular Section 7(e)—by giving the Commerce Commission the power to suspend initial motor carrier rates under the Motor Carrier Act equivalent of Section 4(e) (49 U.S.C. 316(g)). See *infra*, pp. 69–74. Congress' failure to include a similar provision in the Gas Act is consistent only with an intent to leave the initial rate-making function to the companies themselves, with Commission review of initial rates only when required by special circumstances. See *infra*, pp. 86–93. Additionally, Congress in Section 4(e)

[17] Section 4(e) now reads that "Whenever any *such new* schedule [i.e., any rate change filed under Section 4(d)] is filed the Commission shall have authority * * *" to set it for hearing and suspend its effectiveness, and to apply the Section 5(a) rate standard from the filing date. The deletion of the words "such new" would have made Section 4(e) applicable to all rate filings, not merely to rate changes, and would have given the Commission express power to do exactly what respondents seek to compel it to do inferentially under Section 7(e).

(App., *infra*, p. 108) placed the burden of proof of showing the reasonableness of an increased rate on the seller, but did not do so in the case of an initial rate under Section 5(a). The face of the Act thus shows that it is unnecessary for every certificate applicant to carry the burden of showing the "justness and reasonableness" of proposed initial rates in Section 7(e) certificate proceedings, in addition to the burden of establishing that the service is required by the "public convenience and necessity".

2. *Uniform interpretation of the "public convenience and necessity" standard requires balancing of all elements, including rates.* That the "just and reasonable" test is not incorporated in Section 7(e) is also shown by the well-settled meaning of the standard adopted by Congress for gas certification proceedings under Section 7. Section 7(e) contains the conventional or traditional test governing new service—the "public convenience and necessity". *Infra*, pp. 42–44. Rates (as we shall show) are one of several elements bearing on the public convenience and necessity. It does not follow, however, that merely because rates are a factor in the "public convenience and necessity" that the Section 7(e) standard incorporates the "just and reasonable" standards of Section 4 and 5(a) so as to require a formal rate (*i.e.*, "just and reasonable" rate) determination in certificate proceedings. For Section 7(e) requires the Commission to evaluate *all* factors bearing on public interest, not only the proposed rates. It is settled that the public convenience and necessity encompasses all aspects of a proposed service, including such problems as whether

and to what extent there is an unsatisfied need for gas in the area to be served, whether the proposed service offers the greatest probability (when compared with the competing alternatives) of meeting the public needs in the area, the characteristics of the proposed rate structure, the adequacy of the gas supply, and the technical and economic feasibility of the over-all project. *Interstate Commerce Commission* v. *Parker,* 326 U.S. 60, 65; *United States* v. *Detroit & Cleveland Navigation Co.,* 326 U.S. 236, 241; *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.,* 314 U.S. 498, 509–510; *Charleston & Western Carolina Ry.* v. *Federal Power Commission,* 234 F. 2d 62, 64 (C.A.D.C.); *Lang Transportation Corp.* v. *United States,* 75 F. Supp. 915, 926–929 (S.D. Calif.); cf. *Ayrshire Collieries Corp.* v. *United States,* 335 U.S. 573, 592–593). Since the traditional "public convenience and necessity" test requires a balancing, where necessary, of various (often conflicting) elements making up the public interest, the Commission cannot give controlling weight in every case to rates, which are only one of many factors which it must evaluate before authorizing a new gas service. This does not mean that rates are ignored in certificate proceedings but rather that they do not have to be evaluated under statutory standards independent of the public convenience and necessity. See *American Trucking Associations* v. *United States,* 355 U.S. 141, 149.

a. The Commission has invariably applied this principle in examining pipeline and producer rates as an element of the proposed rate structure which must

meet the public convenience and necessity, without converting certificate proceedings into formal rate hearings. It has examined the proposed rates, where possible, comparing them with other comparable rates of the applicant, and evaluating them in the light of its general familiarity with the operating conditions of the applicant and in conjunction with other elements of the rate structure, and the feasibility, desirability, and need for the proposed service. *Infra*, pp. 84–94. If in any case a rate appeared on its face exorbitant or discriminatory, or presented indications of a collusive bargain, this would raise a presumption that the proposed service could not meet the public convenience and necessity and would require a full hearing to determine the reasonableness of the rate. Thus, the Commission in a small number of pipeline certificate proceedings where the existence of monopoly power raises dangers of uneconomic service or discrimination has explored with great care the structure and level of the proposed rate. *Infra*, pp. 86–88. Similarly, in a number of cases involving temporary or permanent certificates where proposed producer rates presented strong possibility of discrimination or triggering of general price rises, the Commission has exercised its discretion to impose rate conditions, in order to meet the public convenience and necessity. See, e.g., *Signal Oil & Gas Co.* v. *Federal Power Commission*, 238 F. 2d 771 (C.A. 3), certiorari denied, 353 U.S. 923. Except in such exceptional cases, however, the Commission (as we show further, *infra*, pp. 85–93) has not either in pipeline or producer

proceedings imposed rate conditions or tested the statutory reasonableness of proposed rates under the "just and reasonable" standard. Rather, it has authorized the proposed service where a strong public need has been shown, and deferred consideration of the proper rate until subsequent proceedings held under Section 5(a) of the Act.

b. There can be no doubt that the balancing of the various factors, including public need, entering into the public convenience and necessity is permitted, and indeed required, by the Gas Act. That public need for gas service can be a major, even a predominant, element of the public convenience and necessity is shown by the many court decisions sustaining Commission action pursuant to Section 7(e). It has been held that the Commission may weigh the *public need* for natural gas against injury to competing fuel interests (*Charleston & W. C. Ry.* v. *Federal Power Commission,* 234 F. 2d 62, 64 (C.A.D.C.); cf. *National Coal Association* v. *Federal Power Commission,* 191 F. 2d 462, 467 (C.A.D.C.)); that in certificating a new gas service in an area served by another company the Commission can rely primarily, if not exclusively, on the *public need* for additional gas (*Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission,* 169 F. 2d 881, 883 (C.A.D.C.), certiorari denied, 335 U.S. 854); that it can deny authorization under Section 7(e) to transport gas for direct sale to industrial customers solely because of the *need of existing resale customers* for additional gas (*Panhandle Eastern Pipe Line Co.* v. *Federal Power Com-*

mission, 232 F. 2d 467, 473 (C.A. 3)); that it can certificate, over State conservation objections, facilities for direct industrial sales where the court concludes that "viewing the matter entirely from the standpoint of ***consumer demand for the gas,*** the evidence is of such conclusive character that it demands the finding that was made" (*Department of Conservation of State of Louisiana* v. *Federal Power Commission,* 148 F. 2d 746, 748–750 (C.A. 5), certiorari denied, 326 U.S. 717, emphasis added; cf. *United States* v. *Detroit & Cleveland Navigation Co.,* 326 U.S. 236, 240–241).

If, as respondents contend, the Commission must make a formal rate determination before certificating any proposed service, and may lawfully certificate only services at rates which are reasonable under the Section 4(a)–5(a) standards, obviously it could not apply the standard of public convenience and necessity in its traditional sense of evaluating and balancing all factors bearing on the public interest. Rather, it would have to give predominant weight to one element, the proposed rate. However, as we have shown, both the Commission and the courts have uniformly given the Section 7(e) public convenience and necessity test its traditional scope by permitting, and indeed requiring, Commission evaluation of *all* relevant factors and interests. Further, as we shall show *infra,* pp. 51–69, in examining the legislative history of the Natural Gas Act, Congress intended the Commission to consider all elements traditionally affecting

the public convenience and necessity in acting under Section 7, not merely or predominantly the one element of rates.

c. The fact that Congress did not expressly incorporate the "just and reasonable" standard in Section 7 but rather adopted the public convenience and necessity test confirms that it must have contemplated some division between the *initial* rate-making powers of the natural gas companies and the Commission's rate regulatory responsibilities.

Such a division has in fact already been recognized by this Court in exploring the interrelationship of Sections 4 and 5(a) in *United Gas Pipe Line Company* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 338-344. In concluding that the Commission could not, by accepting a rate filing under Section 4(d) and making the required findings under Section 4(e), abrogate a fixed-price contract, the Court noted that Congress in the Gas Act intended that rate regulation would begin only after the rate schedule had been filed (350 U.S. at 339):

> * * * the Natural Gas Act permits the relations between the parties to be established initially by contract, the protection of the public interest being afforded by supervision of the individual contracts, which to that end must be filed with the Commission and made public.

As *Mobile* recognizes, Congress contemplated that initial gas rates would be set in the first instance by the parties to a sale and would not at their inception be tested by the Section 4 standard of justness and rea-

sonableness. Although subsequent changes in the filed schedule would be subject to the notice, burden of proof, and suspension provisions of Sections 4(d) and 4(e), and any schedule on file could be examined for reasonableness by the Commission employing the Sections 4(a)–5(a) standard, the gas companies remained free to make their own bargain as to *initial* prices, subject to the Commission's Section 5(a) review powers. As the Court stated (350 U.S. at 338):

> In construing the Act, we should bear in mind that it evinces no purpose to abrogate private rate contracts as such. To the contrary, by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts. * * *

See, for the same holding, *Phillips Petroleum Co.* v. *Federal Power Commission*, 258 F. 2d 906, 917 (C.A. 10); cf. *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division*, 358 U.S. 103, 111–114.

The Gas Act in other words, expressly contemplates that there will be no formal Sections 4–5(a) regulation of the initial rate set in individual negotiations by private parties, which are left free to make their own "individualized arrangements" (350 U.S. at 339). Since the public interest in reasonable rates is protected by regulation of contracts made by the parties on file as rate schedules under the Section 4(e)–5(a) procedure, the Commission is not required to dictate prices in advance to the industry, but only to determine whether the proposed price, together with

other elements, meets the public convenience and necessity.[18]

[18] This conclusion is repeatedly spelled out in the *Mobile* opinion (emphasis added):

> The powers of the Commission are defined by §§ 4(e) and 5(a). The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential." This is neither a "rate-making" nor a "rate-changing" procedure. *It is simply the power to review rates and contracts made in the first instance by natural gas companies* and, if they are determined to be unlawful, to remedy them. * * * [350 U.S. at 341].
>
> * * * These sections [Sections 4 and 5(a)] are simply parts of a single statutory scheme under which *all rates are established initially by the natural gas companies, by contract or otherwise*, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. The Act merely defines the review powers of the Commission and imposes such duties on natural gas companies as are necessary to effectuate those powers; *it purports neither to grant nor to define the initial rate-setting powers of natural gas companies* [*Ibid.*].
>
> [Section 4(d)] * * * provides *only* for *notice* to the Commission *of the rates established by natural gas companies* and for *review* by the Commission of those rates. *The initial rate-making and rate-changing powers of natural gas companies remain undefined and unaffected by the Act* [350 U.S. at 343].
>
> All of the relevant provisions of the Act can thus be fully explained as simply defining and implementing the powers of the Commission to *review rates set initially by natural gas companies*, and there is nothing to indicate that they were intended to do more. Admittedly, the Act presumes a capacity in natural gas companies to make rates and contracts and to change them from time to time, but nowhere in the Act is either power defined. The obvious implication is that, except as specifically limited by the Act, the rate-making powers of natural gas companies were to be no different from those they would possess in the absence of the Act. * * * [*Ibid.*].

We recognize, of course, that *Mobile* involved a construction of Sections 4 and 5(a) of the Act rather than the certificate provision, Section 7. However, respondents' basic contention—that the Commission, in order to protect consumers, must determine initial gas prices—is irreconcilable with the first premise of *Mobile:* that the Gas Act, unlike Part I of the Commerce Act, was not intended to displace completely the use of private contracts as an initial rate-setting mechanism, and that Sections 4(e) and 5(a) provided adequate protection to all parties against unlawful gas rates.[19]

3. *The Gas Act expressly contemplates the possibility that not every rate charged will be "just and*

[19] *Jersey Central Power & Light Co.* v. *Federal Power Commission*, 319 U.S. 61, concerned a similar question of whether the phrase appearing in Section 201(a) of the Federal Power Act (16 U.S.C. 824), "such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States", was to be read into every other part of the Power Act, including Section 203(a) (16 U.S.C. 824b) regulating acquisition of one public utility's stock by another, or whether it was to be given effect only in applying *inter alia* the Power Act rate-filing and review provisions (§§ 205, 206(a)) which are the exact equivalents of Sections 4 and 5(a) of the Gas Act. This Court concluded from the structure and history of the Power Act that the quoted provision, despite its generalized and unrestricted language, was to be given effect as a criterion only in applying the Power Act equivalents of Sections 4 and 5(a) (319 U.S. at 73–78). Similarly, *American Trucking Ass'ns.* v. *United States*, 355 U.S. 141, holds that the policy in Section 5(2)(b) of the Commerce Act (49 U.S.C. 5(2)(b)), limiting railroad acquisition of motor carriers, should not be applied mechanically in Section 207(a) certificate proceedings under the Motor Carrier Act (49 U.S.C. 307(a)), although the policy must be given consideration in such proceedings.

reasonable" in the statutory sense. Respondents may argue that since a proposed producer rate can be statutorily unreasonable, even when it is not exorbitant on its face, Congress could not have intended that the buyer and the ultimate consumers would pay such an unreasonable rate until such time as the Commission prescribed the reasonable rate under Section 5(a). We have shown, however, that Congress has required the objective of "just and reasonable" rates to be reached primarily through the Commission's review powers under Sections 4(e) and 5(a), *Mobile* (350 U.S. at pp. 341–345); and Congress presumed that the Commission would use its Section 4–5(a) powers effectively to protect the ultimate consumer against unreasonable gas prices.

Moreover, Congress deliberately denied the Commission reparation powers under the Gas Act. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618; *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 254; *infra*, p. 50, fn. 30. It follows that Congress must have contemplated that there would be periods during which the rates charged and paid would be other than those ultimately found "reasonable" by the Commission. Thus, the Act provides that the Commission can, by suspending a rate increase for a five month period under Section 4(e), require a gas seller to charge a rate which the Commission may subsequently find to be unreasonably low, even though there is no possibility of restitution. *Hope Natural Gas Company* v. *Federal Power Commission*, 196 F. 2d 803,

806–809 (C.A. 4). Similarly, after a rate has been approved by the Commission under either Section 4(e) or 5(a), a seller is permitted to continue to charge that rate indefinitely until such time as it is again reviewed by the Commission (following complaint or on its own motion) under Section 5(a), despite the fact that in the interim the rate may have become excessive. It is clear therefore that the Natural Gas Act, with its emphasis on private contracts, does not provide a mechanism ensuring that every gas rate charged and paid will at all times be "just and reasonable" in the statutory sense. See *Hope Natural Gas, supra,* 196 F. 2d at 808–809 (C.A. 4); cf. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.,* 341 U.S. 246, 251.

In addition, the purpose of the Gas Act was to fill a gap then existing between State regulation of production operations and State and municipal regulation of gas distribution. *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672, 682; *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission of Indiana,* 332 U.S. 507. When Congress undertook to regulate gas *wholesales* in order to supplement State regulation, it could have given the Commission the same power over wholesale gas rates which the Commerce Commission exercises over rates, including reparation authority, as well as the right to suspend initial rate schedules (*infra,* pp. 69–76). Congress deliberately withheld such reparation power, however, because it was regarded as unnecessary and inappropriate in a federal regulatory scheme "governing

merely wholesale transactions", where retail transactions were State-regulated.[20]

Since the Commission was forbidden to adjust rates retroactively in order to ensure that *all* rates charged and paid were reasonable and non-discriminatory, it follows that the possibility that gas sellers or consumers might be compelled to pay rates for limited periods which are excessive when measured against the rate standards of the Act is not contrary to the pattern of the Act. Such a result is inherent in the scheme of regulation chosen by Congress, which leaves the gas companies free in the first instance to determine rates and proposed service extensions and provides for price regulation only of existing rates, not proposed rates. Congress chose deliberately to preserve the private contract structure of the natural gas industry in adopting a scheme of federal regulation to an industry already heavily regulated by the States. Cf. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 338.

It is therefore clear, we submit, that on the face of the Gas Act the exclusive procedure for applying the "just and reasonable" rate standards of Sections 4(a) and 4(b) to rate changes is provided by Sections

[20] S. Rep. No. 621, 74th Cong., 1st Sess., p. 20. A reparation provision had been included in a progenitor of the Gas Act appearing in a bill subsequently enacted as the Public Utility Act of 1935, but was deleted when it was opposed by State regulatory bodies as inappropriate and unworkable in view of the limited scheme of federal regulation contemplated by the Act. See Hearings, House Committee on Interstate and Foreign Commerce, H.R. 5423, 74th Cong., 1st Sess., pp. 36, 1685; Hearings, Senate Committee on Interstate Commerce, on S. 1725, 74th Cong., 1st Sess., pp. 43, 223, 247.

4(d) and 4(e), and to existing rates by Section 5(a). These provisions, as this Court has pointed out (*Mobile*, 350 U.S. at 344), provide protection for the public interest by allowing the Commission to review actual rates (not proposals) which have been negotiated by natural gas companies and their customers.

B. THE LEGISLATIVE HISTORY OF THE GAS ACT CONFIRMS THAT CONGRESS DID NOT INTEND THE COMMISSION TO PRE-DETERMINE INITIAL RATES

The legislative history of the Natural Gas Act also leaves no doubt that Congress contemplated that the gas companies in the first instance would set their own rates, and that the Commission was not expected to pre-determine initial prices governing new gas sales.

1. *The 1938 enactment.* The primary purpose of the Gas Act, as this Court recognized in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610, was the protection of consumers against excessive gas prices which might result from the monopoly position of the large interstate gas pipelines whose sales in interstate commerce were not subject to State regulation.[21]

[21] The *Hope* principle has been frequently cited in later decisions of this Court, including *Phillips Petroleum Co.* v. *State of Wisconsin*, 347 U.S. 672, 685; and *Federal Power Commission* v. *Interstate Natural Gas Co.*, 336 U.S. 577, 581. Although there can be no doubt as to the correctness of this general view of the Act's purpose, *Hope* was a pipeline rate case under Section 5(a) of the Gas Act where the focus of emphasis was on the public interest in reasonable rates. This Court recognized in that case that it was not directly concerned with the standards applicable in Section 7, stating (320 U.S. at 612):

> [T]he Commission was not asked here for a certificate of public convenience and necessity under Section 7 for any

The Gas Act as originally enacted clearly reflected this basic preoccupation, since Congress at first gave the Commission only limited certification power over natural gas companies. Inasmuch as the main problem, as seen by Congress in 1938, was protection against monopolistic abuses (including discriminatory or exorbitant rates), the Commission under Section 7(c) of the original Act was given control over the initiation of only those new pipeline services entering a market supplied by another gas company. The Commission was directed to certificate such new services if required by "the present or future public convenience and necessity", for the primary purpose of facilitating price competition. It is also clear from the legislative history of the 1938 Act that Congress did not intend the Commission to set initial prices in certificate proceedings, but rather to rely for consumer protection on Sections 4 and 5(a) and the effects of competition which Section 7(c) of the Act was expected to enhance.

Much of the language subsequently employed in the Natural Gas Act, including Sections 4 and 5(a) as enacted but not Section 7(c), appears in a bill, H.R. 11662, introduced into the 74th Congress in 1936 by Chairman Lea of the House Interstate and Foreign

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proposed construction or extension. It was faced with a determination of the amount which a private operator should be allowed to earn from the sale of natural gas across state lines through an established distribution system. Sections 4 and 5, not Section 7, provide the standards for that determination. [See also 320 U.S. at 616–617.]

Certainly, nothing in *Hope* or the cases following it requires a restrictive interpretation of Section 7(e) so as to limit it solely or primarily to questions of rates.

Commerce Committee.[22] In hearings before a subcommittee of this Committee on H.R. 11662, Dozier DeVane, then Solicitor of the Power Commission, in presenting the Commission's views on the proposed bill, stated categorically that the rate powers provided by Sections 4 and 5(a) of the bill (which, as noted, were virtually identical with the provisions finally enacted), were restricted to existing rates, and did not apply to rate proposals (Hearings, pp. 28–29):

> Mr. LEA. Mr. DeVane, under what conditions would rates be put into effect?
>
> Mr. DEVANE. In the beginning?
>
> Mr. LEA. Yes.
>
> Mr. DEVANE. The companies will simply file their schedules.
>
> Mr. LEA. And those schedules would prevail unless the Commission saw fit to, after a hearing and notice, establish a rate?
>
> Mr. DEVANE. Yes, sir; those rates would prevail. The rates that the company makes effective at the date of filing are the rates that will continue in effect until they are changed either by the company, as provided in Section 4, or by the Commission after hearing.

[22] H.R. 11662 was a close copy of S. 2796 which had been introduced during the first session of the 74th Congress. The substance of H.R. 11662 was reintroduced as H.R. 12680, but died with the 74th Congress. A similar bill, H.R. 4008, was introduced into the 75th Congress. This bill was reintroduced with certain modifications as H.R. 6586, which was subsequently enacted as the Natural Gas Act. The Power Commission made no presentation in support of any bill subsequent to H.R. 11662; the hearings held by the House subcommittee in 1937 on H.R. 4008 prior to enactment were concerned with proposed amendments to the Commission-sponsored bill.

Mr. LEA. There would be, I take it, no duty upon the Commission under this bill in the absence of complaint or just reason to call for interference to establish rates.

Mr. DEVANE. No, sir; the Commission can only establish rates after investigation and hearing.

Now, that investigation can be undertaken under Section 5 of the bill either on the Commission's own initiative or upon complaint.

Mr. COOPER. Let me see if I understand you there. That is, the gas companies can establish their rates?

Mr. DEVANE. Yes, sir.

Mr. COOPER. They do not have to go to the Commission, they can establish them themselves?

Mr. DEVANE. You are talking about in the beginning now?

Mr. COOPER. Yes.

Mr. DEVANE. They file their schedule of rates.

Mr. COOPER. And they put them into effect.

Mr. DEVANE. Yes, sir.

Mr. COOPER. And anyone who wants to file a complaint goes to the Commission; is that right?

Mr. DEVANE. That is correct; and they can change their rates, Mr. Cooper, by filing new schedules under Section 4(d). After they have filed them with the Commission and announced those new rates, the Commission has the power to suspend and investigate and the suspending power extends for a period of 5 months.

Mr. COOPER. Well, does the Commission have

the power to suspend as soon as the protest has been filed?

Mr. DEVANE. Not in the case of protests, Mr. Cooper; no sir. The power of suspension only applies to a new rate.

Mr. COOPER. What I mean is this, if the gas company establishes a rate and someone files a complaint against that rate with the Commission, does the Commission automatically suspend the rate?

Mr. DEVANE. It has no authority to suspend that rate.

Mr. COOPER. I see. They first have to consider the case.

Mr. DEVANE. That is correct.

Although H.R. 11662 did not contain the limited certification provision provided by Section 7(c) of the bill finally enacted (App., *infra*, pp. 110–111), the eventual adoption of this provision, which first appeared in H.R. 4008 introduced by Chairman Lea into the 75th Congress, did not contradict in any way, but rather confirms, the original understanding of the Commission expressed by its Solicitor (*supra*, pp. 54–55) that initial gas prices were to be set by the companies—not by the Commission.

Section 7(c), as finally adopted in 1938, did not contain a "just and reasonable" standard but rather a direction to the Commission that it compare relative rates in the area in question before certificating a new service. In the hearings held on H.R. 4008 in 1937, Chairman Lea stated that he was personally responsible for the inclusion of the new limited certification provision (the original Section 7(c), App.,

infra, pp. 111–112), and that its primary purpose was to protect existing gas companies from destructive competition (Hearings, House Committee on Interstate and Foreign Commerce, 75th Cong., 1st Sess., H.R. 4008, pp. 81–84). The Senate subsequently expanded the House Chairman's original concept of the provision by adding a proviso at the end of Section 7(c) which required the Commission, when it authorized service extensions into competitive areas, to give "due consideration" to the public interest in lower gas rates:

> * * * In passing on applications for certificates of convenience and necessity, the Commission shall give due consideration to the applicant's ability to render and maintain adequate service at rates lower than those prevailing in the territory to be served, it being the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.

This proviso, which subsequently was concurred in by the House and appears in Section 7(c) as originally enacted (App., *infra*, pp. 111–112),[22] was designed to make it clear that the Commission in authorizing extensions should consider consumer interest in lower prices, as well as the interest of existing gas companies against destructive competition which had

[22] The proviso was deleted from Section 7(c) in the 1942 amendments to Section 7 which expanded the Commission's jurisdiction over gas services. See *infra*, pp. 63–65.

been Chairman Lea's expressed reason for adopting Section 7(c). The original Section 7(c) cannot be read as requiring the Commission to pass upon the justness and reasonableness of proposed rates in certificate proceedings. It does not impose any such requirement, but rather adopts a relative rate standard, requiring the Commission to compare the level of the proposed rate with the other pipeline rates in the area. Since the prior history of the 1938 enactment makes it clear that Congress and the Commission assumed that gas rates would be regulated under Sections 4 and 5(a), not under Section 7(c), the original Gas Act contradicts respondents' contention that Congress has always intended that the Commission would pre-determine initial prices. Relative rate levels were to be considered in Section 7(c) proceedings—not "justness and reasonableness" ascertained by conventional public utility rate-base methods—and only insofar as the Commission was directed to use its certificate power to break an existing service monopoly, when this would result in lower rates and would otherwise be in the public interest.[24]

2. *The 1942 amendments.* The history of Section 7 as subsequently amended in 1942 also leaves no doubt that the Section 4–Section 5(a) standard of "just and reasonable" was not applicable to Section 7, and that rates were regarded as only one of the elements of the public convenience and necessity which were to

[24] See the testimony of Commissioner Manly, Hearings, House Committee on Interstate and Foreign Commerce, on H.R. 5249, 77th Cong., 1st Sess., p. 19, quoted *infra*, pp. 63–64.

be considered by the Commission in authorizing new service.

By 1942 when the amended Section 7 was enacted, circumstances had changed greatly. The original Act had been passed during a period of economic depression in a relatively static economy. At such a time, the interest of Congress was necessarily focused on the prevention of price abuses in a market in which producer gas was in over-supply, but where the main sellers (the pipelines) held natural monopolies. By 1941 the effects of the defense economy were beginning to be felt, stimulating increased demand for natural gas and a resulting interest in proposed pipeline construction fully documented in the legislative history of the 1942 amendments.[25] These amendments, embodying a changed and expanded philosophy of federal gas regulation, were a response to the pressure of these conditions and to dissatisfaction with the existing Section 7(c).

For it was universally recognized by 1941 that the original Section 7(c) was a failure. The Commission had found Section 7(c) unworkable and undesirable for two principal reasons: (1) the lack of certificate authority over most pipeline extensions made it much more difficult to regulate the operation of such new extensions once initiated; and (2) the Section 7(c) requirement (App., *infra*, pp. 111–112) that the Commission, prior to assuming jurisdiction over a new service, decide the complex economic question of whether the "market" in question was "already being

[25] Hearings on H.R. 5249, House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., pp. 33–34, 61.

served by another natural-gas company" had proved unworkable.[26]

The pipelines did not oppose extension of federal regulation over their own operations, because the lack of a universally applicable and workable certification procedure made it difficult for them to promote and finance pipeline extensions in order to meet the growing need for gas.[27]

Generally expressed dissatisfaction with its then limited certification authority led the Commission to recommend amendment of Section 7(c) in its annual report to Congress for the fiscal year 1940.[28] This report shows that the Commission was at that time primarily concerned about its inability to control the rapidly expanding pipeline industry in the interests of conservation and most effective use of the avail-

[26] Hearings on H.R. 5249, *supra*, at pp. 81–84.

[27] Hearings on H.R. 5249, *supra*, at pp. 3, 35.

[28] The Commission in its 1939 report had already expressed dissatisfaction with Section 7(c) in view of the growing demand for natural gas, stating (p. 21):

> In its administration of section 7(c) of the Natural Gas Act the Commission is aware of the limitations upon its jurisdiction to pass upon applications for certificates authorizing the construction of new facilities. Under the terms of that section the Commission's jurisdiction extends only to applications for certificates authorizing the construction of facilities for the transportation of natural gas to "a market in which natural gas is already being served by another natural-gas company." This limitation upon the Commission's jurisdiction and the lack of clear definition of the word "market" have made more difficult the Commission's administration of this section. *With the growing utilization of natural gas it is not unlikely that the number of applications for certificates under Section 7(c) will increase.* [Emphasis added.]

able gas supplies. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 613, fn. 23. As the report states (p. 78):

> It should be noted that the Commission's jurisdiction over proposed new pipe-line construction is limited to those cases in which the new line will enter the market area already being served by another natural-gas company. This limitation has serious disadvantages in terms of the general purposes of the Natural Gas Act. In the first place, as there is no precise definition of the market area of another natural-gas company, the Commission must decide in each instance whether or not it has jurisdiction. In the second place, it prevents any serious effort to control the unplanned construction of natural-gas pipe lines with a view to conserving one of the country's valuable but exhaustible energy resources.

In support of this recommendation, the Commission in 1941 drafted an amendment to Section 7, which was introduced into the First Session of the 77th Congress as H.R. 5249.[29] In hearings on this bill before the House Committee on Interstate and Foreign Commerce in July 1941, Chairman Manly, on behalf of the Power Commission, after outlining the difficulties the Commission had experienced in

[29] The bill was originally introduced as H.R. 4819, which was revised and resubmitted as H.R. 5249. H.R. 5249 was prepared in cooperation with the National Association of Railroad Utilities Commissioners as well as other interested groups. Hearings, *supra*, pp. 3, 38, 50. The amendment, insofar as here pertinent, was enacted substantially in the form presented by the Commission. See H. Rept. 1290, 77th Cong., 1st Sess. pp. 1–6.

applying the existing Section 7(c), pointed out that pipelines had also encountered difficulties in financing service extensions and other new facilities because of the limited scope of Section 7(c) (Hearings, *supra*, p. 3):

> * * * It may perhaps have been the thought of Congress that certificates would not be applied for except in those cases where communities now actually being served by a natural-gas company were proposed to be served by a new competing company. In practice, however, it has been found that the promoters and builders of pipe lines find it necessary or desirable either to have certificates from the Commission or to have an official determination that a certificate is not required. This is especially true where the proposed pipe line is to be financed by the sale of securities to the investing public or to financial institutions. This usually involves a long and tedious proceedings to determine jurisdiction even before the merits of the case are considered.

Later in his statement, Chairman Manly made it clear, in commenting on the derivation of the proposed amendment from Part II of the Commerce Act, that rates were only one of a number of factors that the Commission was required to consider before certificating gas services (*id.* at 5–6):

> In that connection, Mr. Chairman, I think it is very desirable to point out this fact, that even though under the existing section a proposed pipe line may not be under the jurisdiction of the Commission, under this certification section, during the period of its financing and construc-

tion, it does become subject to the jurisdiction of the Commission the minute it begins to operate and transport and sell natural gas, so that you are confronted with the situation under the present section that during the most important period in relation to a company—namely, the period in which it is being promoted, in which it is being financed, in which it is being constructed—the Commission may have no jurisdiction whatsoever and be confronted the day it begins operation with a financial structure or with a route which may have been highly undesirable from the standpoint of the public interest.

* * * * *

This amendment will not only eliminate the long and expensive investigations which have hitherto been necessary to determine the Commission's jurisdiction but will, we believe, have the effect of promoting the development of the natural-gas industry along lines which will be consistent with the public interest.

I wish to emphasize what seems to me to be the most important aspect of the proposed amendment from the standpoint of the public interest. *It will have the effect, in our opinion, of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves, the feasibility of the proposed services, and the characteristics of the rate structure at a time when such vital matters can be revised and modified as the public interest demands.* Without this authority the Commission is too often confronted with a situation in which it must either accept conditions which appear to be undesirable from the public stand-

> point or take the alternative course of subsequently requiring changes which may have much more serious consequences than would have been the case if such changes had been effected before the public was invited to invest in the new enterprise. [Emphasis added.]

Chairman Manly was then asked whether the Commission had considered it mandatory under the original Section 7(c) to give paramount weight to lower consumer rates in issuing new service authorizations. The Chairman, in response to a question by Congressman Boren, emphasized that the Commission did not consider the level of rates to be paid by the ultimate consumer the sole criterion under the original Section 7(c), and that a certificate might be denied by the Commission even where it would result in lower rates (*id.* at 18–19):

> Mr. BOREN. I want to ask if this amendment, in your judgment, in anywise changes section (c) of the original act in which, at least, it is my opinion, that the committee had the definite intention of making it a mandate to the Commission to issue a certificate where a company could definitely show that it could provide the services of natural gas at a cheaper cost to the ultimate consumer.
>
> Commissioner MANLY. I do not think so, sir. I think that is specifically reserved in paragraph (g); but it is not made mandatory, not spelled out, for the reason that *it is not the only criterion that can be set up.* [Emphasis added.]

Chairman Manly was then asked whether the Commission could give consideration to the public need for

expanded gas service in considering certificate applications (*id.* at 23–24):

> Mr. SOUTH. As a practical matter, the authority given to the Commission here could be used—and I am wondering if it is generally used—for the purpose of broadening or extending the application in such a way as to better serve the public interest.
>
> Commissioner MANLY. This has been the case, I am sure, in the administration of all of the cases that have come before this Commission. * * *
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> * * * * * *
>
> Take, for example, this certain case involving the so-called Nevada case, the case of the Nevada Transit Co., which originally proposed to build a line into Arkansas, I believe it was, for the purpose of furnishing gas to some cement mills down there at materially lower rates than were being charged by the company furnishing the service.
>
> The Commission, after extended hearings and so forth, authorized the issuance of the certificate but required as a condition for the issuance of the certificate that the company should agree to serve those communities lying along the route of the proposed pipe line that they were going to build. They had not applied for the right to serve those communities, but the Commission felt that for the proper protection of the public they should be required to do so.

It is clear, therefore, that the Commission did not consider rates to be the exclusive criterion under either the original or the proposed Section 7(c); that Congress was made aware that the Commission had

treated and would continue to treat the public need for gas as an element of the "public convenience and necessity" under the proposed amendment; and that rate levels were only one of a number of factors which could be considered in authorizing new or expanded gas services. Following Chairman Manly's testimony as to the Commission's understanding and practice, Congress enacted the present Section 7(c) which contains the conventional "public convenience and necessity" standard.

Thus, although the hearings on H.R. 5249 (the 1942 bill) demonstrate that rates were regarded as one element which could be considered by the Commission in Section 7(c) proceedings, they also show the complete absence of any Congressional intention to limit the Commission's discretion by requiring it to give paramount consideration to rates at the expense of other elements of the public convenience and necessity.

Further evidence for this conclusion is found in the fact that, during the hearings on H.R. 5249, one of the majority members of the House Committee, Congressman Boren of Oklahoma, had favored an express limitation on the Commission's powers to condition the grant of service authorizations. Following his statement earlier in the hearing (*supra,* p. 63) that the Commission should give mandatory weight to the reduction of consumer rates in its service authorizations, Congressman Boren proposed that the Commission's discretion under Section 7(e) should be limited to the imposition of "conditions affecting rates, services, and things of that nature" (Hearings, at 24–25):

Mr. BOREN. I have no objection at all to the Commission having power to exact conditions such as you outline. My objection is not to the power exercised under those conditions, but to the language of the bill which does not limit you in the sort of conditions you should exact. I do not mean by that to infer any lack of confidence in the Commission, because I do not mean it that way at all; but I do mean as a general principle, I think we are going too far in giving just general grants of arbitrary power to bureaus and commissions and the executive branch in general, and I would like to see some limiting language there. As to this condition you mentioned, I think you should have that power; but then there should be some restrictions on what conditions could be exacted; whether the provision itself is a sufficient guarantee or not.

Commissioner MANLY. Yes. I am quite sure the Commission will have no objection to the inclusion of language which will indicate or limit the power to relevant, material, reasonable terms and conditions, which is further limited, you see, by the requirement that the public interest and necessity should require such conditions.

Mr. BOREN. *We can limit those conditions to conditions affecting rates, services, and things of that nature.*

Commissioner MANLY. *I would ask that you do not attempt to specify, because when you specify, you can never anticipate all of the situations that are going to arise. In fact, you usually do not anticipate the ones that customarily arise, and under the rules of construc-*

tion, if you specify them, you have limited the type of conditions that can be attached. If you make it reasonable, relevant, and material, so that the party has a right to go into court if the Commission attempts to get tyrannical or arbitrary, fine; but when you try to spell out the terms and conditions, you do make it awfully hard to administer. [Emphasis added.]

Significantly, no limitation on the discretion of the Commission to condition service authorization was included in Section 7 as re-enacted in 1942.

The Committee reports on H.R. 5249 strengthen our conclusion. The House Report (H. Rept. 1290, 77th Cong. 1st Sess., pp. 2–3) states in commenting on the need for the proposed amendments:

> Section 7(c) of the Natural Gas Act, as at present in force, has proved unsatisfactory not only from the standpoint of administration by the Commission, but also the natural-gas companies themselves, as well as to the producers of competing fuels and the operators of competitive methods of transportation whose economic interests may be affected by the construction or extension of natural-gas pipe lines. * * *
>
> * * * By the unregulated construction of a pipe line, uneconomic construction, or inflated costs may make proper regulation of operation thereafter difficult or practically impossible. *The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves, the feasibility and adequacy of the proposed services, and the characteristics of the rate structure in connection with* the pro-

posed construction or extension at a time when such vital matters can readily be modified as the public interest may demand. * * * [Emphasis added.]

Similarly, the Senate Report on the same bill (S. Rept. 948, 77th Cong. 2d Sess., pp. 1–2) states:

> Provisions of the Natural Gas Act empower the Commission to prevent uneconomic extensions and wastes, but it can so regulate such powers only when the extension is to "a market in which natural gas is already being served by another natural-gas company." Thus the possibilities of waste, uneconomic and uncontrolled extensions are multiple and tremendous. The present bill would correct this glaring inadequacy of the act. *It would also authorize the Commission to examine costs, finances, necessity, feasibility, and adequacy of proposed services. The characteristics of their rate structure could be studied.* Obviously these are powers that Federal Power Commission should have and should exercise in the public interest. [Emphasis added.]

It is evident, therefore, that the Section 4–Section 5(a) standard of "just and reasonable" was not intended to be applied mechanically to Section 7(e) proceedings, and that the "characteristic of the rate structure" is only one of a number of elements which the Commission was supposed to consider in authorizing new gas services, the necessity or need for the service also being given prominence. In fact, the emphasis was placed by Congress on elements of the proposed service which once having been determined could not thereafter be changed or remedied without

major economic loss and dislocation. Rates—the reasonableness of proposed rates to particular customers, in contra-distinction to the over-all structure of rates proposed by the company—could always be adjusted in subsequent Section 5(a) proceedings. Individual rates, unlike other aspects of public convenience and necessity, are the one element over which it is practicable for the Commission to exercise continued surveillance. Hence, it is entirely consistent with the purpose of the amended Section 7 to defer time-consuming consideration of the proposed rates themselves to subsequent proceedings in order to permit adequate exploration of other elements of the public convenience and necessity. See *infra*, pp. 84–100.

In sum, the history of Section 7 shows unmistakably that rates were only one of several elements which *could* be considered by the Commission in passing upon the "public convenience and necessity" under that Section.

C. OTHER FEDERAL REGULATORY AGENCIES INTERPRETING PARALLEL STATUTES HAVE UNIFORMLY REFUSED TO MAKE RATE FINDINGS IN CERTIFICATE PROCEEDINGS

It has been the uniform practice of every federal regulatory agency operating under a statute parallel or similar to the Gas Act to defer consideration of the reasonableness of proposed initial rates until subsequent formal rate proceedings.

1. *Motor Carrier Act.* The Interstate Commerce Commission, as this Court noted in *Schaffer Transportation Co.* v. *United States*, 355 U.S. 83, 91–92, in interpreting the statute from which Section 7(e) of the Gas Act directly derives, has consistently refused to pass upon the reasonableness of proposed

motor carrier rates in certificating new motor carrier services under Section 207(a) (49 U.S.C. 307(a)) of the Commerce Act.[29a]

Section 216(d) of that Act (49 U.S.C. 316(d)) parallels Section 4(a) of the Gas Act in providing that:

> All charges made for any service rendered or to be rendered by any common carrier by motor vehicle engaged in interstate or foreign commerce in the transportation of passengers or property as aforesaid or in connection therewith shall be just and reasonable, and every unjust and unreasonable charge for such service or any part thereof, is prohibited and declared to be unlawful. * * *

Section 207(a) governing certification of motor carrier services by the Commerce Commission is virtually identical with Section 7(e), which directly derives from it.[30] Section 207(a) provides that:

> a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operations covered by the application, if it is found that the applicant is fit, willing, and able properly to perform the service proposed and to conform to the provi-

[29a] The apparent absence of decisions passing on rates in certificate proceedings under Part I of the Interstate Commerce Act (Section 1(18)) indicates a similar practice in certificating rail services.

[30] "The proposed amendment to section 7 follows, in general, the legislative scheme of the sections of the Motor Carrier Act of 1935 governing certificates of public convenience and necessity." Hearings before the House Committee on Interstate and Foreign Commerce on H.R. 5249, Report of Federal Power Commission, 77th Cong., 1st Sess., p. 82; *id.* at pp. 5, 20; H. Rept. No. 1290, 77th Cong., 1st Sess., p. 2.

> sions of this part and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, to the extent to be authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied * * *.

This Court has recognized the broad discretion granted by the language of Section 207(a). *Interstate Commerce Commission* v. *Parker,* 326 U.S. 60, 65:

> Public convenience and necessity is not defined by the statute. The nouns in the phrase possess connotations which have evolved from the half-century experience of government in the regulation of transportation. When Congress in 1935 amended the Interstate Commerce Act by adding the Motor Carrier Act, it chose the same words to state the condition for new motor lines which had been employed for similar purposes for railroads in the same act since the Transportation Act of 1920, § 402 (18) and (20), 41 Stat. 477. Such use indicated a continuation of the administrative and judicial interpretation of the language. Cf. *Case* v. *Los Angeles Lumber Co.,* 308 U.S. 106, 115. The Commission had assumed, as its duty under these earlier subsections, the finding of facts and the exercise of its judgment to determine public convenience and necessity. This Court approved this construction. *Chesapeake & Ohio R. Co.* v. *United States,* 283 U.S. 35, 42. Cf. *Gray* v. *Powell,* 314 U.S. 402, 411–412. The purpose of Congress was to leave to the Commission authoritatively to decide whether additional motor service would serve public con-

> venience and necessity. Cf. *Powell* v. *United States,* 300 U.S. 276, 287. This, of course, gives administrative discretion to the Commission, cf. *McLean Trucking Co.* v. *United States,* 321 U.S. 67, 87–88, to draw its conclusion from the infinite variety of circumstances which may occur in specific instances. * * *

This broad construction by the Court of language which is identical with and the source of Section 7(e) cannot be reconciled with respondents' contention that public convenience and necessity is limited in every case to the consumer's interest in lower gas rates.

In exercising its discretion under Section 207(a) of the Motor Carrier Act, the Commerce Commission, despite repeated attacks by competitors and shippers on the reasonableness of rates proposed by motor carrier certificate applicants, has consistently refused to pass upon rates in certificating motor carrier services, holding that that issue could be explored in subsequent proceedings under Section 216(e) of the Commerce Act (49 U.S.C. 316(e)), the precise equivalent of Section 5(a) of the Gas Act. *Omaha & Council Bluffs Ry. & Bridge Co.,* 52 M.C.C. 207, 234–235; *Joseph Pomprowitz,* 51 M.C.C. 343, 350; *D. A. Beard Truck Lines Co.,* 34 M.C.C. 3985, 415; *Fred Lindeman,* 29 M.C.C. 183, 185; *Becker Transportation Co.,* 26 M.C.C. 487, 497; *A. D. Paddison,* 21 M.C.C. 324, 327.[31] The Commerce Commission has justified

[31] The fact that the Commerce Commission, unlike the Power Commission under the Gas Act, can suspend initial rates as well as rate changes under Section 216(g) of the Commerce Act (49 U.S.C. 316(g)), underlines the fact that Congress did not intend in the Gas Act to require Commission predetermination of wholesale gas rates. Although both initial motor carrier rate filings and rate changes are suspendible, such rates

this policy as follows in *Omaha & Council Bluffs Ry., supra:*

> * * * Transit argues that the level of fares to be charged by the Street Car Company is one of the most substantial facts affecting the public interest that is involved in these proceedings, and that if the national transportation policy has any meaning, the matter of economical service as between rival applicants is as important as the determination of the question of whether a need exists for the service * * *.
>
> * * * * * *
>
> We have consistently refused to consider the issue of rates as pertinent in proceedings of this nature, since that is a matter for which other provisions of the act provide a remedy. Accordingly, whether or not the present or future level of rates charged by either applicant is on a proper basis is a matter that cannot properly be considered herein, and certainly could not be determined on the present record. If not otherwise so, the reason becomes obvious from the arguments Transit itself presents which demonstrate the complexity of the subject of rates and the correctness of our view that the issues involved therein are such that they should not be confused with those involved in application proceedings.

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go into effect automatically at the end of the seven month suspension period without any provision for a refund. It follows that the motor carrier rate provisions in Part II of the Commerce Act offer substantially less protection to the shipper than the co-ordinate Gas Act provisions to the gas consumer; but the Commerce Commission has consistently refused to apply the "just and reasonable" standard in motor carrier certificate proceedings. It follows *a fortiori* that it need not be applied in natural gas proceedings.

Since the language of the two Acts is virtually identical and, as we have said, the Gas Act provision was directly derived from Part II of the Commerce Act (*supra*, p. 70, fn. 30; cf. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 584; *Hope Natural Gas Co.* v. *Federal Power Commission*, 196 F. 2d 803, 806–807 (C.A. 4)), respondents must necessarily meet the burden of showing that Congress in adopting the Section 207(a) language in the Gas Act did not also adopt the Commerce Commission's interpretation of that language which was then fully developed (see *Becker Transportation Co.*, 26 M.C.C. 487, 497 (1940); *A. D. Paddison*, 21 M.C.C. 324, 327 (1940); *Petroleum Carrier Corp.*, 21 M.C.C. 124, 125 (1939); *Baggett Transportation Co.*, 19 M.C.C. 609, 612 (1939)). It is established, of course, that Congressional adoption of prior statutory language carries with it the prevailing interpretation of that language unless the express contrary is shown by the legislative history of the subsequent enactment. *Interstate Commerce Commission* v. *Parker*, 326 U.S. 60, 65; *United States* v. *Ryan*, 284 U.S. 167, 175; *Armstrong Paint & Varnish Works* v. *Nu-Enamel Corp.*, 305 U.S. 315, 332; *United States* v. *C.I.O.*, 335 U.S. 106, 112–113.

It follows that the long continued interpretation and practice of the Commerce Commission fully supports the legality of the Power Commission's practice of generally deferring appraisal of producer rate levels to Section 5(a) proceedings.[32]

[32] As we have shown, there is nothing in the legislative history of the Gas Act which contravenes this conclusion. The

2. *Water Carrier Act.* The Commerce Commission has also refused to consider rate issues in passing upon water carrier certificate applications under Section 309(c) of the Commerce Act (49 U.S.C. 909(c)), despite the requirement in Section 305(a) of that Act (49 U.S.C. 905(a)), paralleling Section 4(a) of the Gas Act, that all water carrier rates must be just and reasonable.

The scope of the Commission's discretion under Section 309(c) was described by this Court in *United States* v. *Detroit & Cleveland Navigation Co.*, 326 U.S. 236, 241:

> The Commission is the guardian of the public interest in determining whether certificates of convenience and necessity shall be granted. For the performance of that function the Commission has been entrusted with a wide range of discretionary authority. *Interstate Commerce*

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framers of the Act, as originally adopted, intended that the Commission, except in exceptional cases, should regulate gas rates only after they were placed in effect by company agreement. The legislative history of the amended Section 7 (*supra*, pp. 57–69) also shows that Congress did not intend to limit the exercise of the Commission's discretion in granting certificates under Section 7(e) but, to the contrary, contemplated that the Commission would be free to consider and balance all the usual elements affecting the public convenience and necessity, including the public need for the service. There is nothing in the history of Section 7 which shows that Congress intended the Commission to pre-determine natural gas initial prices. The testimony by the Commission's Chairman, *supra*, pp. 63–67, shows affirmatively that price was only one of several factors which could be considered by the Commission in passing upon the public convenience and necessity, and that the "just and reasonable" standard was not a mandatory test under Section 7(e).

> *Commission* v. *Parker*, 326 U.S. 60. Its function is not only to appraise the facts and to draw inferences from them but also to bring to bear upon the problem an expert judgment and to determine from its analysis of the total situation on which side of the controversy the public interest lies. * * *

The pertinent language of Section 309(c), the water carrier certificate provision, is identical with Section 7(e); yet the Commerce Commission, as noted, has always refused to consider water carrier rates in certificate proceedings, holding that "the rates which an applicant may charge are not determinative of its right to a certificate." *Coast Transportation Co.*, 250 I.C.C. 469, 471.[33]

3. *Civil Aeronautics Act.* The Civil Aeronautics Board, another federal agency with rate jurisdiction equivalent to that of the I.C.C. and the F.P.C., whose experience is instructive, has similarly declined to consider the question of rates in air carrier certificate proceedings in Section 401 of the Civil Aeronautics Act of 1938 (49 U.S.C. 481) (which paralleled exactly Section 7(e)) despite the express Congressional mandate in Section 404 of that Act (49 U.S.C. 484) that an air carrier must "establish, observe, and enforce just and reasonable individual and joint rates." *Delta Air Lines*, 14 C.A.B. 1149, 1163; cf. *United Air Lines, Inc.* v. *Civil Aeronautics Board*, 155

[33] The Commission has also applied the same rule in freight forwarder certificate proceedings under Part IV of the Commerce Act (49 U.S.C. 1004, 1010). *R.T.C. Terminal Corp.*, 265 I.C.C. 527, 532; *Your Freight Forwarder, Inc.*, 285 I.C.C. 425, 431.

F. 2d 169, 174–176 (C.A.D.C.); *National Airlines, Inc.*, 14 C.A.B. 331, 347–350; *General Passenger-Fare Investigation*, 17 C.A.B. 230, 232–235; *West Coast Common Fares Case*, 15 C.A.B. 90, 93.[34]

4. *The Federal Communications Act.* Although there seem to be no reported decisions relating to the question, we have been reliably informed that the Communications Commission has never in any case investigated the reasonableness of proposed rates in telephone and telegraph certificate proceedings under Section 214 of the Communications Act (47 U.S.C. 214), despite provisions in Sections 202–205 of that Act (47 U.S.C. 202–205) exactly paralleling Sections 4(a) and 7(e) of the Gas Act.

In summary, the language and structure of the Gas Act, the Act's purpose and legislative history, and the long-standing construction of parallel statutes by the Commerce Commission, the C.A.B., and the F.C.C. point to the twin conclusions: the rates initiating gas sales (at wholesale) need not be pre-determined by the Federal Power Commission but may be set by the parties in the first instance subject to the Commission's powers of review under Section 4(e) and 5(a) of the Act, and that "public convenience and necessity" (not "justness and reasonableness") is the controlling standard under Section 7(e).

[34] It should be noted that, while the Civil Aeronautics Board has rate suspension powers equivalent to those in Section 4(e) of the Gas Act, it is expressly forbidden to suspend initial rates (49 U.S.C. 642(g)). The cited provisions of the Civil Aeronautics Act have been re-enacted in the Federal Aviation Act of 1958 (Act of August 23, 1958, Secs. 401, 404, 1002(g), 72 Stat. 754, 760, 788).

D. OUR POSITION IS SUPPORTED BY TWO DECISIONS OF THE DISTRICT OF COLUMBIA CIRCUIT

The District of Columbia Circuit, the only court thus far to pass on the issue, has held in *Oklahoma Natural Gas Co.* v. *Federal Power Commission*, 257 F. 2d 634, No. 288, this Term, dismissed on February 20, 1959, and *Florida Economic Advisory Council* v. *Federal Power Commission*, 251 F. 2d 643, certiorari denied, 356 U.S. 959, that the Commission need not make formal rate determinations before certificating new gas services.

The *Oklahoma Natural* proceeding involved competing applications under Section 7(e) of the Natural Gas Act by two pipeline systems to supply gas for consumption in Chicago and surrounding areas. Under one proposal, a part of the additional gas supply was to be obtained from sales by independent producers from acreage in Northern Texas. Oklahoma Natural Gas Company, a gas distributor operating entirely within Oklahoma, intervened in the consolidated applications contending that these sales should not be certificated at the proposed price on the ground that this would cause an increase in the price of gas which it purchased within Oklahoma. The Commission refused to require the producers to accept the prevailing price in Oklahoma as a condition to obtaining a certificate (R. 300–394, 512–543, No. 288, this Term), finding that the proposed price for the Texas sales would not trigger an increase in Oklahoma, and that it was not inconsistent with the public convenience and necessity. Oklahoma Natural sought review of the certificate order in the District of Colum-

bia Circuit, urging that the Commission was required to find that the price proposed in every Section 7(e) proceeding was just and reasonable, at least where the price was contested. The Court of Appeals (Danaher and Bastian, *JJ.*, with Bazelon, *J.* dissenting), upheld the Commission on the ground that the Gas Act did not impose any such mandatory requirement, stating (257 F. 2d at 640):

> Petitioner contends that in a certificate proceeding under § 7(e), where the price being paid by a producer is above that then being paid by others in the specific area, the Commission must either impose a price condition or determine the justness and reasonableness of the price, as in a proceeding under §§ 4 and 5, 15 U.S.C.A. §§ 717c, 717d. In other words, it is contended that the Commission, in such a situation, has no discretion but must take one of the two courses. We think not. Section 4(a) states the substantive objective of the Act, that rates be reasonable; it does not specify the procedure by which this objective is to be attained. That procedure is prescribed by §§ 4 (d), 4(e) and 5(a). The Commission cannot be required to convert every certificate proceeding into a rate proceeding.

The court also held that the Commission did not abuse its discretion in finding that the public convenience and necessity required the sales at the proposed price (257 F. 2d at 640–641):

> It is obvious that the plain congressional meaning is to vest the Commission with the discretion to attach terms, including rate conditions. It is fitting that there should be this

> discretion and, in the absence of an abuse of that discretion, courts should not interfere. We find no such abuse here.
>
> * * * * *
>
> We are unable to state that the facts developed at the hearings do not support the Commission's findings and conclusions.

The court in *Oklahoma Natural* relied on an earlier holding of another panel of the same court (Bazelon, Fahy, and Burger, J.J.) in *Florida Economic Advisory Council* v. *Federal Power Commission,* 251 F. 2d 643, certiorari denied, 356 U.S. 959 (Bazelon, J., dissenting there, likewise), sustaining a Commission order certificating a natural gas pipe line transporting gas to markets in Florida. A principal contention of interveners in that proceeding, renewed before the Court of Appeals (251 F. 2d at 646, 654) and this Court (petition for certiorari, No. 911, Oct. Term, 1957, pp. 29–31), was that the Commission, prior to certificating the service, should have held a hearing to determine the reasonableness of rates which the proposed pipe line would pay for gas from its producer suppliers. The District of Columbia Circuit stated, in rejecting this contention (251 F. 2d at 646):

> *Suppliers' Rates.* Petitioner claims the Commission should have held a rate hearing to determine the lawfulness of the rates to be charged by the gas suppliers. But this inquiry may be resolved in a rate proceeding rather than in a proceeding for a certificate of public convenience and necessity, and the Commission did not abuse its discretion in declining to consider the matter in the instant proceeding. The

> rates are subject to the Commission's continuing jurisdiction, and, whenever sufficient reason appears, they may be taken up. * * * [35]

The District of Columbia Circuit has twice held, therefore, that the Section 4–5(a) standard cannot be read into Section 7(e), and that Congress has not imposed a requirement that the Commission pre-determine natural gas prices, by appraising proposed rates in the light of the "just and reasonable" standard.

V

THE COMMISSION HAS NOT ABUSED ITS DISCRETION IN REFUSING TO PRE-DETERMINE INITIAL PRODUCER RATES

We have shown thus far that Congress contemplated that gas wholesale prices would be set in the first instance by natural gas companies in an industry which was intended to retain a basis in private contract. Since the Commission was given continuing authority over the prices adopted by the companies under Sections 4 and 5(a), this was thought sufficient to protect the consumer against discriminatory or excessive rates without entirely eliminating private price agreements. Respondents may argue, however,

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[35] Judge Bazelon, dissenting in *Oklahoma Natural*, sought to distinguish this statement as *dictum* (251 F. 2d at 654) on the ground that the petitioner in that case had not claimed that the producer rates were in fact unlawful. The same can be said as to *Oklahoma Natural*, however. The basic attack against the Commission's procedure in both cases was not that the proposed rates were patently unlawful but that it was unclear from the record whether they were lawful, and for that reason a rate hearing must be held prior to certification (compare petitioner's brief, No. 13,833, C.A.D.C. pp. 38–40, with petition for certiorari, No. 288, this Term, p. 22).

that assuming such a scheme was adopted by Congress, experience has shown that complete Commission control over initial producer prices is necessary for consumer protection; and that this being the case, the Commission, in applying the public convenience and necessity standard, has abused its discretion in not making formal rate determinations or imposing specified or contingent prices in all contested producer certificate proceedings, as it has in certain pipe line and producer certificate proceedings.

We have seen, however, that the scheme of gas regulation adopted by Congress does not contemplate that the Commission will entirely take over the task of setting initial rates for the industry, and that Congress intended that rate regulation under Sections 4(e) and 5(a) would provide an effective mechanism for consumer protection against unreasonable prices. It follows that the Commission's refusal in many instances to pre-determine producer prices is entirely consistent with the basic purposes of statute and does not, standing alone, constitute an abuse of discretion in determining the public convenience and necessity in new producer sales. *Schaffer Transportation Co.* v. *United States,* 355 U.S. 83, 88; *American Trucking Associations* v. *United States,* 355 U.S. 141, 149–150.

Where as here the Commission's general regulatory policies and program are consistent with the statutory purpose, Congress as we have shown, *supra,* pp. 32–81, has endowed the Commission with broad discretion to determine in particular cases the extent of the enquiry it will make into rates proposed

by certificate applicants. As this Court has said in reviewing Commerce Commission findings under a provision which was the model for Section 7(e) (Section 207(a) of the Motor Carrier Act, *supra*, pp. 70–71; *United States* v. *Pierce Auto Freight Lines*, 327 U.S. 515, 535–536):

> We think the court misconceived not only the effects of the Commission's action in these cases but also its own function. It is not true, as the opinion stated, that "* * * the courts must in a litigated case, be the arbiters of the paramount public interest." This is rather the business of the Commission, made such by the very terms of the statute. The function of the reviewing court is much more restricted. It is limited to ascertaining whether there is warrant in the law and the facts for what the Commission has done. Unless in some specific respect there has been prejudicial departure from requirements of the law or abuse of the Commission's discretion, the reviewing court is without authority to intervene. It cannot substitute its own view concerning what should be done, whether with reference to competitive considerations or others, for the Commission's judgment upon matters committed to its determination, if that has support in the record and the applicable law.

We shall show in this part that the Commission has not abused its discretion in refusing in many cases to impose rate conditions, since a program of pre-determining initial producer prices in all contested cases would be undesirable and impracticable at this stage of producer regulation. We shall also

show that the Commission's policy of authorizing sales by independent producers following the *Phillips* decision has been consistent not only with the policies of the Act but with the public interest in general, including the immediate and long range interests of the existing consumers of natural gas.

A. THE COMMISSION COULD NOT HAVE EFFECTIVELY PRE-DETERMINED INITIAL PRODUCER RATES AT THIS STAGE OF PRODUCER REGULATION

1. As a result of the *Phillips* decision in 1954 a distinctly different segment of the industry has been brought for the first time under active federal regulation. The gas production industry differs in important respects from the gas transportation or pipeline industry, so that much of the Commission's experience prior to *Phillips* could not be applied directly to the independent producers. Hence, as the Commission has moved forward with a program of producer regulation, it has been confronted with a number of immediate problems analogous but not wholly similar to those met by the Commission at the outset of pipeline regulation.

Although regulation of the interstate pipelines was delayed during World War II, the Commission by the end of the war had been able to develop a formula and method for appraising pipeline rates, which had been tested and approved by this Court in *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591; and *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581. It was therefore in a position, following the war, to

apply this formula in the system-wide Section 5(a) proceedings appraising the reasonableness of pipeline rates, and in isolated cases where required by the public interest (*infra,* pp. 86–88) in examining the reasonableness of rates in proceedings granting pipeline certificates.

The Commission recognized from the beginning of gas regulation that the design of a pipeline rate structure is an important element of the public convenience and necessity, to be evaluated in passing on a new service application. Since pipelines usually are natural monopolies *vis a vis* their existing customers who have invested in facilities for the use of gas, and their rate structures are developed for the most part unilaterally (see *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division,* 358 U.S. 103), pipeline rates present possibilities of discrimination or over-reaching which were not presented by production or distribution of natural gas.

In addition, the rate structures for proposed pipeline extensions or new systems, unlike producer rates, are invariably complex, multi-volumed documents based on many inter-related factors which make it extremely difficult for the Commission to require major adjustments after the schedules have been placed in effect.[36]

[36] Although the Commission has continuing regulatory jurisdiction over pipeline rate structures, the adjustment of such structures once they have been placed in effect presents many difficulties which are aggravated by the fact that pipelines in most cases sell to numerous buyers. Revision of cost allocation formulas to eliminate discrimination, for example, may require drastic and unexpected readjustments in other areas of a pipe-

The Commission has also been required to scrutinize proposed pipeline rates in order to be able to determine the economic feasibility of proposed pipeline projects, since it is impossible, practically speaking, to remedy a basically uneconomic pipeline once the physical facilities have been constructed, and the consumers may have to bear the burden of such a line indefinitely. Producer certificate applications, in contrast, are filed only after the wells have been drilled and gathering and related facilities constructed, so that no questions of economic feasibility can arise.

The Commission, primarily for these reasons, has required pipeline certificate applicants to present data supporting their proposed rate structure (Gas Regulations, Section 157.14(a)(18), 18 C.F.R. 157.14(a)(18)), and scrutinizes such proposed rate structures for possible discrimination, with close attention to cost classifications and allocations and the form of the proposed rate (*i.e.*, demand-~~community~~ commodity, cost of service, etc.). In appraising proposed pipeline rate structures, the Commission also examines the level of the rate in the light of cost data provided by the applicant; where the proposed rate appears excessive in the light of this evidence and past Commission experience, the Commission will often require submission of additional cost data. In 29 pipeline proceedings (approximately 1.9% of pipeline applications involving service extensions passed upon by the Com-

line's business. Producer rates, in contrast, are readily adjusted since they normally involve only a single sale transaction to a single buyer.

mission between 1949 and 1957, inclusive)[37] the Commission has required as a condition to granting the certificate that the applicant file, either immediately or at some future time, a rate schedule which differed (or might differ) from that submitted with its original proposal. These rate conditions have taken a variety of forms, including specification of a particular rate to be filed, or the filing of an interim or contingent rate.[38]

[37] During these years, the Commission certificated in excess of 1,560 separate pipeline extensions. Rate conditions requiring actual or potential acceptance of a rate other than that agreed to by the parties were imposed in only 29 of these proceedings. A number of the remaining proceedings involved individual sales from existing facilities which were certificated on the condition that the sale be governed by the pipeline's existing rate schedule covering the area and type of service in question. However, there was no rate controversy in these cases since there was no underlying contract providing a different rate, inasmuch as the parties contemplated that their sale would be subject to the pipeline's tariff. (These routine conditions are included in the enumerated rate conditions reported in F.P.C. Annual Reports, 1951, p. 110; 1952, p. 111; 1953, p. 112; and 1954, p. 128.)

[38] The various types of conditions are summarized in the Commission's Report for the fiscal year 1952 (pp. 110–111):

> It is the policy of the Commission, whenever possible, to reach agreement on the various rate problems arising in connection with certificate applications prior to or during the hearings on such applications. When this cannot be done, it is necessary to condition the certificates issued in such proceedings, to require the filing of proper rates sometime in the future. Such rate conditions are in one of four general forms, depending upon the particulars of the case involved. First, the applicant may be required to file a definite and specific rate; i.e., the proper rate is spelled out in dollars and cents. Second, the condition may require the filing of rates satisfactory to the Commission, shortly before commencement of the proposed service. This al-

In the overwhelming majority of pipeline certificate cases, the Commission has authorized the extension or new service under the pipeline's rate schedule or the rate proposed by the applicant and its customers, as contemplated by the Gas Act (*supra,* pp. 32–81). In almost every such case, the rate placed in effect has later been reviewed prospectively for reasonableness in subsequent Section 4(e) proceedings resulting from rate increase applications.

2. When the Commission undertook to regulate independent-producer new service applications following *Phillips,* it discovered that the factors which had made it feasible and desirable for the Commission to enquire closely into certain pipeline initial rates were not presented by most independent producer certificate applications. *Tamborello,* 11 P.U.R. 3d 413, 417.

At the time when *Phillips* was decided in June 1954, the Commission was engaged in regulating approximately 100 gas pipeline companies which filed an average of 700 new or revised rate schedules, and between 150 and 200 applications for service extensions, annually. In August 1954, following *Phillips,* the Com-

lows the applicant to more accurately determine construction and operating costs and practices, and to determine proper rates by using this information. Third, the Commission may allow certain rates to become effective for an interim period of operation, with permanent rates to be filed on the basis of actual operating experience during the interim period. Fourth, a certificate authorizing deliveries to a new resale customer, by an existing pipeline system, may be conditioned to require that the sale be initiated under the pipeline company's applicable existing rate schedule. Such a condition eliminates the possibility of rate discrimination against new customers.

mission began to receive a large volume of producer certificate applications governing sales already being made on June 7, 1954, the date of the *Phillips* decision. Along with these applications, it also received a growing volume of producer applications seeking authorization for new sales at rates negotiated by the parties. By December 1954, when the final revision of Commission regulations specifically applicable to the over 4,000 independent producers was adopted (Order No. 174B, 18 CFR 154.91, *et seq.*), the Commission was confronted with 1,400 producer rate and certificate filings monthly, or a total of 16,800 applications, which had to be passed upon during the first year of producer regulation.

In addition to this greatly augmented regulatory responsibility, the Commission, as we have noted, was required to overcome many of the initial problems which it had faced at the beginning of pipeline regulation. The pipeline industry has many of the characteristics of a traditional public utility. Typically, individual interstate gas pipelines possess a relatively uniform capability for providing a dependable volume of service, the earnings from which will defray their relatively high initial capital costs (financed on a long term basis) and their substantial operating costs. All of these costs are relatively ascertainable and even predictable, and reasonable rates can be set by ascertaining whether, if applied to the volume of service rendered, they will produce revenues that will equal "costs of service" (including a fair return on the net capital investment).

The production of natural gas contrasts sharply. There is the widest range of capital investment and volume of production in relation to each other—depending on the success had in striking gas. Operating costs for the producing wells, after they have been brought in, are relatively low or even nominal. Any producer who is attempting to stay in business has another annual cost which bears no ascertainable relationship to a particular well or field. For there must be continual exploration and development of new gas reserves resulting in unsuccessful surveys and searches, dry wells, and small producing wells at a cost that constitutes a large fraction of the industry's total annual cost.

Such cost has little or no necessary relationship to the costs which can be shown for a particular well, field or geographical area of a given producer. Moreover, it is difficult if not impossible to ascertain the extent to which the fraction of such costs shown for a particular well, field, or area may correspond to the industry average. Thus a peculiarly baffling problem is presented of deciding what, if any, use can be made of "costs" of a particular well, field, or area in determining just and reasonable rates that will properly reflect this cost or provide the necessary incentive for continued exploration and development of new reserves.

Despite a major effort on the Commission's part to regulate the producers effectively and expeditiously under all provisions of the Gas Act, these marked economic differences in the two segments of the natural gas industry made it impossible, as we have

noted, to draw immediately on the Commission's past experience in attacking the problems of regulating producer rates. Since the gas production and the pipeline industries differ sharply in almost every important economic aspect, many of the formulas, rules, principles, and techniques developed for appraising pipeline rates were inapplicable to producer sales. Additionally, data on producer operations were entirely lacking, including producer costs and cost allocations, which are normally employed in the development of a rate formula. These difficulties were compounded by the impossibility (because of lack of appropriations) of suddenly augmenting the Commission's technical staff to deal with and pass upon the enormously increased volume of rate filings and service applications. The lack of service experience as to comparable sales, as well as the fundamental economic differences between the two industries, made it impossible for the Commission to develop immediately a workable formula for applying the "just and reasonable" standard to producer rates under Section 5(a) of the Act. See *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (C.A.D.C.), certiorari denied, 352 U.S. 829; *Bel Oil Corp.* v. *Federal Power Commission*, 255 F. 2d 548, 553 (C.A. 5), certiorari denied, 358 U.S. 804; and *Gulf Oil Corp.* v. *Federal Power Commission*, 255 F. 2d 556, 557 (C.A. 5).

In the absence of either service experience or a rate formula which would allow the fixing of reasonable rates in Section 5(a) proceedings, the Commission found it impossible to set a reasonable price for a proposed producer sale in Section 7(e) certificate proceed-

ings by relying on an existing rate formula, following its practice in certain pipeline certificate proceedings. There can be no doubt, therefore, that the Commission did not abuse its discretion in failing to pass upon the reasonableness of proposed producer initial rates prior to certificating producer sales, since it would have been impossible for it to have done so on any rational basis.

3. It might be argued that, assuming the reality of these obstacles, the Commission nonetheless should have made a general practice in contested producer cases of conditioning the grant of producer certificates on the acceptance of a specified rate, or a contingent rate, as it has in certain pipeline proceedings; and that it could thereby delay rate appraisals until such time as service experience was available and rate criteria had been developed. Specifically, it might be argued that the Commission should adopt as a general rule the procedure which it originally attempted to follow in this case, and require that every contested producer initial rate be set at some determined level and then allow the producer to file any increase provided by its contract over this level, which would then be suspended and placed in effect subject to refund (see *supra*, p. 6).

It is true that the Commission has imposed rate conditions involving specified and contingent rates in a number of producer certificate proceedings where the circumstances presented a strong possibility of discrimination, triggering of general price rise in unregulated rates, or other unusual factors indicating that the sale should not be certificated absent the

condition."[39] There is no doubt as to its power to impose such conditions. *Tamborello*, 11 P.U.R. 3d 413, 415–417. We shall show, however, that the imposition of interim rates or other rate conditions as a general practice in producer certification would be contrary to the public interest at this point in producer regulation.

a. A preliminary difficulty with the general adoption of such a procedure is that the Commission at this point in producer regulation, often has no rational basis on which to determine the price which it would require the producer to accept in lieu of its contract price pending a rate hearing. There can be no doubt that the Commission may impose under Section 7(e) only reasonable conditions and conditions required by public convenience and necessity, so that, even assuming the propriety of initial price determinations, any rate imposed on a gas company as a condition to authorizing a sale would have to have some reasonable basis in the record before the Commission. Yet it is

[39] See *Cities Service Gas Co.*, 12 P.U.R. 3d 3, affirmed, *Signal Oil & Gas Co.* v. *Federal Power Commission*, 238 F. 2d 771 (C.A. 3), certiorari denied, 353 U.S. 923; compare *Tamborello*, 11 P.U.R. 3d 413. Approximately 4,860 initial producer rate filings have been received since the *Phillips* decision, of which only 140 have been contested. Most producer rate conditions have been imposed in granting temporary authorization to begin service under Section 7(c) of the Act (App., *infra*, p. 111). These conditions have required the applicant to agree to accept retroactively whatever rate the Commission may find required by the public convenience and necessity in subsequent permanent certificate proceedings. Approximately 50 conditions of this type have been imposed. See, e.g., *Sunray Mid-Continent Oil Co.*, Docket No. G–16134; *app. pdg.*, *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, CA10, No. 6061; *Amerada Petroleum Co.*, Docket No. G–16029; *Shell Oil Co.*, Docket No. G–13878; and *Humble Oil & Refining Co.*, Docket No. G–17772.

precisely the absence of reliable evidence as to service experience which normally makes it impossible for the Commission to evaluate producer initial price proposals prior to certification. Many certificate rate controversies arise in proceedings involving sales from newly developed areas, as here, where there is a paucity of operating experience, and drilling and gathering costs are largely in the realm of conjecture. Any price which the Commission might attempt to impose pending review of the proposed rate would be based on conjecture or on other prices in the area, or prices paid by the same purchaser in other areas, which have not been appraised by the Commission and which might or might not bear some relation to the rate in question. *Seaboard Oil Co.*, 19 F.P.C. 416, 423.

The 17¢ per Mcf price which the Commission originally sought to have the producers accept in this proceeding (R. 528–529) was probably subject to this defect. Although this was the highest price which Tennessee Gas was then paying, the Commission had no way of determining whether that price was at all an appropriate rate for the Catco sale, so that the justification for requiring the parties to substitute that price for the contract price of 21.4¢ per Mcf, even for a limited period of time, would be obscure.[40]

[40] Adoption of the practice of imposing a price ceiling based on the purchaser's own highest previous price paid for gas would merely have the effect of awarding the gas to the pipeline that had previously paid the highest price, irrespective of comparative need for the gas. See R. 247a–251a.

Recognizing this fact, the Commission, in the proceedings here in question, coupled its 17¢ per Mcf rate proposal with the suggestion that the producers file for an immediate rate increase which would be allowed by the Commission to go into effect immediately, subject to refund. This order, had it been agreed to by the parties, would have resulted in a contingent rate pending the outcome of Section 4(e) proceedings on the rate increase, the respective parties being liable retroactively to charge and to pay the rate ultimately found reasonable by the Commission.

b. Whatever the merits of adopting such a procedure in this particular case, it would have been impossible, practically speaking, for the Commission to employ it as a general rule in dealing with contested producer initial rates at this stage of producer rate regulation. If every contested initial rate were to be placed in effect on a contingent basis, this would mean that neither party to a producer sale would know, possibly until years later, at what price they had contracted to buy and sell gas. For the reasons stated, *supra*, pp. 86–88, a pipeline, confronted with such a condition, can forecast with fair accuracy the *minimum* price which would ultimately be allowed by the Commission; but a producer, before undertaking development of new acreage, would have no way of anticipating, prior to drilling, what figure (or range of figures) would finally be selected by the Commission as a reasonable price for the gas. Since principles governing cost allocation, depreciation, tax treatment, and allowable rate of return applicable to producer sales had not and could not have been developed by

the Commission at the times here in question, a producer could not forecast the general area of the return it might hope to obtain if its exploration activities proved productive.

In sum, had the Commission uniformly required the producers and their customers to accept contingent rates for sales from newly developed areas (which are the source of most producer certificate rate controversies), producers prior to drilling in those areas would have had no adequate way of forecasting whether the allowable return would be adequate to meet their expenses, since they could not anticipate with any accuracy what those expenses would be or what the Commission would consider as legitimate. Since gas exploration or "wildcatting" is often financed on a short term basis, wildcatters (usually the medium-sized or smaller producer companies) might have been unable to obtain financing since they could have given no assurance of being able to market any gas they might find at a price commensurate with the risk of their over-all operations.

As a result, had the Commission followed the general practice of imposing contingent rates, the result almost certainly would have been a substantial reduction in natural gas exploration activities during the post-*Phillips* period, except in cases where a producer had an assured gas market which was not subject to the Commission's jurisdiction.[41] Since one

[41] Some additional gas reserves also might have been discovered as result of drilling for oil which is often produced in conjunction with gas. The fact that a contingent rate would not have been imposed in all cases would not have relieved the un-

purpose of the Gas Act plainly was not to stifle gas exploration and production, the Commission did not abuse its discretion in refusing to adopt a general policy of compelling the producers to accept contingent rates where their contract prices were questioned. *Hope Natural Gas Co.*, 19 F.P.C. 405, 408.

4. There is a further reason why it would have been impracticable, if not impossible, for the Commission to enquire into the validity of producer rates in individual proceedings, even through the mechanism of setting a contingent price.

Pipeline rate conditions, almost without exception, have been imposed in certificate proceedings involving major pipeline extensions which constituted substantially new and independent services.[42] It is possible in such cases to set a rate for the new service or extension based on its separate costs of operation and the total system costs, employing accepted allocation techniques, without special review of the pipeline's entire operations which in most cases would be generally familiar to the Commission from other proceedings. Because of the very different character of the gas production industry, however, it is sometimes impracticable to make separate determinations of rates governing a particular producer sale or sales, although this may be possible in the case of larger

certainties of the individual producer prior to drilling in undeveloped acreage, since he could not foresee the rate which would be allowed by the Commission in his case.

[42] Minor pipeline service extensions or sales usually are subject to the pipeline's existing rate schedules applicable to the area in question, and hence do not present rate controversies. See *supra*, pp. 87–88.

producers whose operations are conducted within well defined and historically distinct areas.

The reasons for this spring from the nature of gas production operations. Rate controversies, as we have said, have usually arisen in producer certificate proceedings seeking authority to sell gas produced from one well or a group of wells in a newly developed field or acreage. Although it may be possible to determine, after a period of operation, the production costs of these particular wells, and the producer's exploration and development costs applicable to the field in question, it may be impracticable to set a reasonable rate, including a fair return, without some consideration of the producer's over-all cost and revenue position which can only be explored in a combined proceeding reviewing all of the producer's operations and rates.

This results from the fact that the producer, as we have already noted, *supra*, p. 90, must continually explore for gas in order to stay in business, and must be able to recover in the price it receives for the gas it discovers and sells the cost of these exploration activities, a part of which inevitably will be unproductive. Although there may be exceptions in the case of larger producers with well developed production areas, these unproductive exploration costs in many cases have to be assigned to sales made from productive acreage so as to achieve an equitable distribution of this element of the cost of producing gas among the various ultimate consumers of the com-

modity."[44] See *Forest Oil Corp.* v. *Federal Power Commission*, No. 16844, C.A. 5, February 20, 1959, slip op. p. 5. Where this is the case, the unproductive exploration costs in a limited area may have to be viewed simultaneously with the producer's other sales and production costs in a single Section 5(a) proceeding."[45]

It would not be possible to obtain a broad view of a producer's operations by collecting and combining its certificate proceedings over a period of time, as a substitute for a Section 5(a) proceeding. In the first place, the Commission could not delay indefinitely producer authorizations until it had collected and consolidated a group of certificate applications without producing stagnation in the production industry, with long-term, adverse effects on consumer gas supplies. And even had the Commission forced the applicants to accept contingent rates, it still would be unable to review an applicant's overall operations in rate proceedings held subsequent to the certificate hearings, since at best only part of the producer's rate structure would be before it, unless it deferred review of the contingent rates to the completion of system-wide Section 5(a) proceedings. This, as we have seen,

[44] Problems in making this type of allocation are under current consideration by the Commission in a number of proceedings under Section 5(a) involving producer rates. See *infra*, p. 100, fn.46.

[45] The problem of making this allocation is complicated *inter alia* by the fact that many producing gas wells are operated marginally or even at loss, as a result of state conservation regulation, or geological factors.

would probably have had the disadvantage of substantially curtailing production activities for an indefinite period.

It follows that the Commission was on sound ground when it normally declined to explore the validity of the isolated producer rates in certification proceedings but rather deferred such questions to Section 5(a) proceedings, involving the entire jurisdictional operations of the producer. Section 5(a), or combined Section 4(e)–5(a) proceedings, examining the existing rates of most major gas producers in every important production area are now in progress, and others will be instituted as necessary staff and facilities become available. The Commission in these proceedings is currently exploring the proper allocation of costs and allowable rates of return required by the unique character of the producer's business.[48] Realistic and practicable answers to these questions can be obtained only through information developed in these proceedings, and such answers must be found before a workable formula for producer regulation can be evolved. Thus, as in the case of the pipelines, a producer rate formula will be developed in the course of Section 4(e)–5(a) proceedings involving system-wide rates, not by the examination of rates

[48] The Commission also, in December 1957, instituted the so-called "Omnibus" proceeding (Champlin Oil & Refining Company, Docket Nos. G–9277, *et al.*) in which a major effort is being made to collect and analyze producer rate schedules on file with the Commission, and to assemble data bearing on the costs and economics of gas production, competitive market criteria, the economics of ultimate markets for gas, and related topics. This consolidated study is intended to supplement the general Section 5(a) investigations now in progress. F.P.C. Annual Report, 1958, pp. 77–78.

governing isolated sales forming only a part of a producer's operations.[40]

B. GAS CONSUMERS HAVE RECEIVED ADEQUATE PROTECTION IN PRODUCER CERTIFICATE PROCEEDINGS

Although the difficulties we have enumerated have prevented the Commission from achieving rapidly a comprehensive, full-scale program of producer rate regulation, they have not thus far resulted in any substantial loss to the consumer of natural gas. The Commission, despite the greatly increased demand for additional gas services, has been able by effective use of its suspension and review powers under Section 4(e) and 5(a) of the Act to protect the consumer against unjustified rate increases pending completion of the major Section 5(a) proceedings now under way, involving rates of major producers in each important production area.

Since the *Phillips* decision in June 1954, the Commission has received approximately 5,260 producer rate increase filings (other than increases based on State production taxes), involving total increases of $120,000,000.00, on an annual basis. The Commission has suspended approximately 2,000 of these increases, involving $91,000,000.00, and has permitted to go into

[40] It will be recalled that the rate conditions imposed in pipeline certificate proceedings, to which reference is made, were adopted for the most part *after* the development of applicable rate criteria in system-wide Section 5(a) proceedings such as those involved in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591; *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575; and *Colorado Interstate Gas Co.*, v. *Federal Power Commission*, 324 U.S. 581.

effect without suspension approximately 3,260 increases involving $29,000,000.00. The proceedings in which no suspension order was issued involved, in almost all cases, either rates which were well below the general level prevailing in the field in question or filings which provided for merely *de minimis* increases. In such cases, the Commission has exercised its discretion in not suspending the increases under Section 4(e), in order to keep within manageable limits the burden on its staff in reviewing other rates and rate increases.

During the same period, as we have already noted, *supra,* p. 93, approximately 4,860 initial producer rate schedules were filed (in conjunction with new producer certificate applications) of which only 140 involved contested rates.

The Commission's decision not to pre-determine, as a general matter, the proposed initial rate in these cases, but to rely on its pending suspension proceedings under Section 4 and on Section 5(a) rate proceedings, has not resulted in significant increases in the prices paid by consumers for natural gas during the post-*Phillips* period. In fact, the Commission has largely succeeded during a period of generally rising prices in preventing substantial increases in the cost of gas paid by interstate pipeline companies as well as the rates charged by those companies to gas distributors by the use of selective rate suspensions pending development of a rate formula and the completion of major Section 5(a) proceedings.

The average cost of gas purchased by all pipelines from independent producers between 1954 (the year

Phillips was decided) and 1957 (the latest date for which figures are available), inclusive, increased from 9.9¢ per Mcf to 12¢ per Mcf, during a period when the wholesale price index increased from 110.3 to 117.[47] During the same period, the average price paid by residential consumers for natural gas increased only from 89.3¢ per Mcf to 93¢ per Mcf,[48] while the consumer price index increased from 114.8 to 121.6.[49] A 3.7¢ per Mcf average increase in the cost of residential gas, when viewed in the perspective of rising material and service costs borne by producers and pipelines during this period, while not *de minimis,* is clearly of not such a magnitude as to reflect adversely on the general policies adopted by the Commission, given the difficulties with which it has been confronted during the initial stage of producer regulation.

In summary, the Commission has neither violated the purposes of the Act nor abused its discretion in refusing to pre-determine all initial producer rates at this early stage in producer regulation. The Gas Act does not require the Commission to set initial pro-

[47] B.L.S. Statistics, reported in Economic Report of President, 1958, p. 156 (1947–1949=100).

[48] United States Department of Interior, Bureau of Mines: *Minerals Year Book* 1954, Minerals Market Report (1957) M.M.S. No. 2833, Average increase (or decrease) in the ten major consumer states for the same period was as follows (all in ¢ per Mcf): New York (147.5–152.2); Massachusetts (231.2–220; decrease); New Jersey (202.9–212.7); California (73.9–75.6); Connecticut (253.1–176.7; decrease); Michigan (95.2–92.8; decrease); Illinois (102.9–102.3; decrease); Pennsylvania (91.9–95.5); Ohio (66.4–71.8); and Wisconsin (134.5–125.7; decrease).

[49] B.L.S. Statistics, reported in Gas Facts, American Gas Association (1957), p. 224 (1947–1949=100).

ducer rates, and it would be impracticable and unwise for it to attempt to do so at this time in every contested case. Nor is such a procedure required by the public convenience and necessity or for the protection of gas consumers in view of the Commission's extensive powers over rates under Section 4 of the Act, and the pendency of Section 5(a) proceedings investigating the over-all rate structure of the industry. At this point in producer regulation, the Commission's discretion should not be restricted to the use of any pre-conceived procedure or method of producer regulation. Rather, it should be left free to develop those techniques and formulas which are best adapted to the unique characteristics of the production industry, and most capable of effectuating the Congressional purpose of consumer protection against excessive gas prices.

CONCLUSION

We do not, as previously stated, urge that the judgment below be reversed, but only that the main grounds expressed by the Court of Appeals be disapproved by this Court. Should the Court for any reason reach the broad statutory questions sought to be raised by the present petitioners, we respectfully submit that the Commission' position, as discussed in Points IV and V, above, is sound and should be adopted by the Court.

Respectfully submitted.

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I have authorized the filing of this brief.

J. LEE RANKIN,
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APRIL 1959.

APPENDIX

1. The Natural Gas Act of 1938, 52 Stat. 821, as amended, 15 U.S.C. 717, *et seq.*, provides in pertinent part:

> SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.
>
> (b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.
>
> (c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this Act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.
>
> (d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classifica-

tion, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided*, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after

it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same

by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * * * *

SEC. 7. (a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical conection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided,* That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available

supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That

the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest.

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require.

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

* * * * *

2. As originally enacted June 21, 1938 by Public Law No. 688 (H.R. 6586), 75th Congress, 3d Session,

Chapter 556, 52 Stat. 821, 825, Section 7(c), read as follows:

(c) No natural-gas company shall undertake the construction or extension of any facilities for the transportation of natural gas to a market in which natural gas is already being served by another natural-gas company, or acquire or operate any such facilities or extensions thereof, or engage in transportation by means of any new or additional facilities, or sell natural gas in any such market, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require such new construction or operation of any such facilities or extensions thereof: *Provided, however,* That a natural-gas company already serving a market may enlarge or extend its facilities for the purpose of supplying increased market demands in the territory in which it operates. Whenever any natural-gas company shall make application for a certificate of convenience and necessity under the provisions of this subsection, the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission. In passing on applications for certificates of convenience and necessity, the Commission shall give due consideration to the applicant's ability to render and maintain adequate service at rates lower than those prevailing in the territory to be served, it being the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.

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